

## **Territorial Disputes in the South China Sea: Economic Implications for the Region**

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### **Abstract**



*This research paper explores the territorial disputes in the South China Sea and their economic implications for the regional countries focusing on their geo-economic and geostrategic significance. The South China Sea holds substantial importance because of the high percentage of global trade passing through it. The historical claims of Beijing on the Paracel and Spratly Islands against the UNCLOS provide a baseline of territorial disputes with ASEAN countries. For research methodology, the author relies on qualitative analysis using secondary data sources. To develop a theoretical framework for this complex issue, the author applies theories of **Neo-Realism**, **Maritime Regional Security Complex**, and **Security dilemma**. This paper is aimed at exploring economic implications for regional states in case of potential conflicts emerging in case of engagement among regional as well as external powers. This research has emphasized the development of a Beijing-ASEAN forum focused on establishing economic, diplomatic, and security ties for the creation of the **Eastern Economic Block** at a broader level.*

**Keywords:** South China Sea, Economic Implications, Strategic Competition, ASEAN, UNCLOS, Strait of Malacca, Dispute, Nine-dash line

### **Introduction**

The South China Sea is considered to be one of the most critical maritime crossroads for international trade. In 2016, \$3.4 trillion in trade was estimated to pass through this region, representing around 21% of global trade. Despite being so crucial for world trade, the South China Sea is a hot belt of conflicts among global and regional powers such as China, Vietnam, Philippines, Malaysia, Brunei, and Taiwan, in dispute for sovereignty over diverse islands and reefs. Global powers like the United States are also now involved in the region's dispute. Some experts say World War third might erupt from this region. This shows the intensity of ongoing conflicts in the region.

### **Dispute in the South China Sea**

There are several reasons for the dispute among various states in the South China Sea. The primary source of this clash is the claim of different countries over different territories and the demarcation of the sea. The Sea is an important cradle of natural resources. There are exclusive economic zones (EEZ) that different countries claim differently, overlapping for different territories. Thus, the maritime dispute impacts the relations among the countries that partnered with the dispute and the series of regional and bilateral relations economically and diplomatically (Kong, Huang, & Yang, 2023).

China's claim over the South China Sea exacerbates the dispute through the nine-dash lines, and other countries reject this claim by following the United Nations Conventions of the Law of the Sea (UNCLOS). Under the law, each country bordering the maritime boundary has an Exclusive Economic Zone (EEZ) that ranges 200 nautical miles (around 370km) from the coast where they have their sovereign claims. The law was agreed and signed in 1982 by China and other bordering countries to the South China Sea. The Association of Southeast Asian Nations (ASEAN) has long tried to reach an agreement to reduce the animosity over sea claims. Still, significant progress has not yet been achieved (Medcalf, 2023).

Unfortunately, the UNCLOS guidelines are ambiguous and are unable to define clear maritime borders because there is a further 12 kilometres of the zone which is included in the

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country's territorial boundary based on the country's geography. UNCLOS is also unable to determine the situation in which a state has multiple islands in different locations as in the case of China. In this way, UNCLOS further complicates the situation.

Basically, in the South China Sea, there are four disputed claims:

- 1) China exerts control and assertiveness over the nine-dash line area which includes Parcel and Spratly Island.
- 2) Vietnam has claims of control over the Parcel and Spratly Islands.
- 3) Based on the geographical closeness, the Philippines have claims over the Spratly Islands.
- 4) Concerning Exclusive Economic Zones (EEZ), Malaysia and Brunei claim territories that fall under EEZ according to the United Nations Conference on the Law of the Sea (UNCLOS) (Quyet, 2023).

*The People's Republic of China* has ancient historical records that have its roots back to the fifteenth century showing that China retained control over almost the entire waterway. China also claims to have a legal right over the region but has been unsuccessful in evidencing its claim over the maritime regime. China's nine-dash lines cover almost 90% of the region and claim that the territories that fall under this line belong to China. *Vietnam* also raises its claims grounded on inheritance. In the 1970s, when the relationship between China and Vietnam deteriorated, Vietnam raised its claim over the region. *Malaysia* has a claim over territory in the Southern Spratly Islands, which comes under Malaysia's continent. This makes their claim acceptable on legal grounds. *Indonesia* has assertions over the only part of the sea that derives under its exclusive special economic zone. The *Philippines* also has assertions only on part of territories that come under their exclusive economic zones, and their claim is also based on historical grounds. *Brunei's* claims are also based on their special Exclusive Economic Zone (EEZ) as mentioned by the UN Convention on the Law of the Sea (Saha, 2020).

### **Research Questions**

1. What is the economic significance of the South China Sea for Beijing and ASEAN countries?
2. What are the Economic Implications for regional countries in case of disputes in the South China Sea?

### **Theoretical Framework**

To deal with this strategic region of the South China Sea, the author has relied on more than one theoretical perspective. The theory of *Neo-Realism* perfectly fits the behavior of the PRC in the region as assumptions of the theory conclude that in this anarchic international system, states take actions to secure their national interests.

The *Theory of Maritime Security Complex* presented by Barry Buzan and Ole Waever also sets the stage for analyzing complex economic and security concerns. It would help to analyze the complex interlinked maritime security concerns of the states in this region.

*Security dilemma* would assist the author in articulating a comprehensive analysis of security concerns and in turn naval arms race among the potential rivals, the two regional hegemony; the US and China.

### **Analysis**

#### **Strategic Competition: US and China**

China's sweeping claim over the South China Sea region will give China an upper hand in the US-China global power race. China's Claim over the South China Sea through the nine-dash line almost covers the entire region which China featured in its national map this year. The map troubles the countries involved in the conflicts, including Malaysia, the Philippines, and Vietnam. In 2016, an international tribunal ruled that the map provided had no legal grounds, but Beijing ignored the rulings. China has maintained assertive actions with military buildups, particularly in the Parcel and Spratly Islands in pursuit of more territorial claims. Recently, satellite images have shown how China is growing its assertion over the maritime region by increasing the size of islands and constructing new islands so that EEZ may increase. It is also reported that China has militarised Woody Island by deploying military equipment such as cruise missiles, fighter jets, and radar systems.

Other global and regional players such as the United States, Russia, Japan, and India are also playing their roles in the dispute increasing the complexity. The countries assume the Chinese actions as a threat and aim towards safeguarding their elements of power in the context of politics, economy,

and military. The US not only challenges China's claims in the region but also conducts Freedom of Navigation Operations (FONOPs) and provides bolstering support to the Southeast Asian countries.

The United States entered into a dispute under the Mutual Defense Treaty of 1951 with the Philippines claiming its role of maintaining the equilibrium by implementing the Freedom of Navigation Operations (FONOPs). The US also supports the claims of some of China's neighboring states. The defense treaty further complicates the situation in the region. In this way, the region has turned into a hot battleground for the US-China rivalry. Following the US's directions against their common adversary, Japan is also playing its part with the sale of its armed ships and tools to the Philippines and to Vietnam to counter Chinese aggression and improve their maritime security.

Also, the US has augmented the dispute in the region with a wide range of security pledges in East Asia and has connected with countries adjoining the South China Sea such as Singapore, Vietnam, and the Philippines. In this way, any dispute with these countries may directly affect the United States. The potential escalation of the conflict could have serious consequences for the whole world (Stock, 2014).

### **Economic Significance of the South China Sea**

The South China Sea is advantageously significant for international trade and accommodates nearly one-third of global maritime traffic. Annually, goods valued at **more than \$3 trillion** pass through the region and connect the economies of Asia with the markets of Europe, Africa, and the Americas. Concerning natural resources, according to the Council of Foreign Relations (CFR), the sea is estimated to have **11 billion barrels of unexploited oil and natural gas of more than 190 trillion cubic feet**. The sea has an abundance of fish resources. Approximately **12% of the world's total fish catch** occurred here, a source of livelihood for thousands of hundreds of people (Kittrie, 2022).

In terms of natural resources, the South China Sea has abundant deposits which attract competitive interest among different states. The resources are not yet exploited as other natural resources in the world and therefore remain relatively untapped. As per testimony by the World Bank, the entire region is estimated to have 900 kilolitres of natural gas and oil treasury. These massive quantities of natural resources have the potential to help the smaller states of South-eastern Asia to flourish and industrialize. In the disputed waters, the Chinese Energy corporations are currently in progress for oil exploration and drilling but there is much hostility and discontent among other smaller countries that have also claims over these maritime territories.

In 2016, over 64% of China's maritime trade and Japan's 42% took place through the South China Sea. However, the United States is comparatively less reliant on the region, and over 14% of its oceanic trade passed over the South China Sea. The sum of all the trade's estimated value of \$2.7 trillion in 2009, for \$3.5 trillion in 2010. The figure that emerged in late 2010 was significantly higher and estimated at \$5.3 trillion. However, this figure overestimates the values of trade taking place. For example, the estimation also includes exports of the United States to China even though some of its trade does not use the South China Sea maritime territory.

It shows the South-East Asia Sea functions as a trade route for most of the global shipments. China is an economic giant and the only country that is challenging the United States for the status of regional hegemon in the global south, the region is essential to Beijing. It is estimated that among the top ten transport ports, most are only positioned in this region with almost 50% of the oil tankers passing through the region only. More than a billion people live in the South China Sea. The dispute is impacting them economically. It is important to mention here that some of the world's emerging economies are also located in this region such as ASEAN countries. Their economic growth is now tied to the stability and peace of the region.

In case, Beijing succeeds in taking control of the region by following its claim of "nine-dash lines", the impact will be felt globally. China will dictate to other countries on their terms affecting the principle of free navigation. Concurrently, this will lead to unfavorable effects on the economies of countries around the region. Without free navigation oil prices will skyrocket as a result of alternative rerouting.

According to the reports of the United Nations Conference on Trade and Development (UNCTAD), around 80% of universal trade by volume and by 70% value, of the global trade is carried out by sea. Out of this 80% of trade, 60% of maritime trade is transported through Asia, and more than one-third of this trade occurs through the South China Sea. It shows how significant this maritime region is for countries such as China, Taiwan, and Japan. These countries depend on the

**Strait of Malacca**, which connects the South China Sea and the Indian Ocean. China, the second largest economy in the world, is much dependent on this maritime region (Türkeş, 2018).

### **Economic Implications**

Due to these significant trade routes, the South China Sea has attracted momentous attention. The potential threat in the region and dependence on the Strait of Malacca has raised concerns about its liability. Some documents also reported that annual goods worth around \$5.3 trillion transit through only the South China Sea. Out of this \$5.3 trillion, trade with the United States accounts for \$1.2 trillion. These statistics show the intensity of the economic implications it could have on the region (Kim, 2015).

A research report published by the US National Bureau of Economic Research explained the economic implications of the dispute. A military conflict in the region could force the shipping to divert around the south of Australia from other continents that were routed to Asia. The extra shipping cost will affect the economic activity in the region and worldwide.

The study assumes that the Strait of Malacca which is situated between Malaysia and Indonesia could stop all the east-west channels between the Indian and Pacific Oceans through the South China Sea. ***The alternative which is the rerouting of all the existing trade through the Strait of Torres to the north of Australia would be impracticable.*** The route is hazardous for large vessels because of its shallow depths (Fravel, & Glaser, 2022).

*The suspension of the trade will affect Taiwan's economy and squeeze by a third, and Singapore's economy will collapse by 22%. Other countries like Hong Kong, Vietnam, the Philippines, and Malaysia will also be affected by the conflict and suffer from the fall of the economy to 10% to 15%. The study also shows Australia would fall between 1.9% to 3.1% and Japan and South Korea by 2% to 3%. The data shows countries that can compensate for the international trade loss by increasing domestic spending will be least affected, such as China. Beijing has huge domestic markets and many ports outside the potential conflict zone but still the implications will be felt.*

The economists have mentioned the real threat, and the consequences will be because of the disruptions of trade in some of the essential goods and services having no substitute, primarily when related to energy imports. This will affect the countries outside the region as well. The study focused on the mutual trade of 51 economies that account for 92% of the world GDP. 19 countries out of these belong to the East, Southeast, and Pacific regions. Thus as a result of increased shipping cost, a significant reduction in trade in more than 61 ports will be observed.

It is also important to mention that there is proximity between economic loss and military spending. Due to the increased hatred, countries start spending more on the military, initiating an arms race in the region. ***The study shows countries located near the Strait of Malacca, which is the epicenter of the conflict, with higher military expenditures have reductions in GDP.*** A standard deviation of roughly 32% means economic loss equals a surge in military spending of above 2% of GDP.

### **Disrupting South China Sea Trade**

The possibility of a military clash in the South China Sea is always high. Any such clash could disrupt the equilibrium of the region. Therefore, it is essential to consider the economic implications for the region. The conflict will affect trade and energy reserves, which are essential for Southeast Asian countries. Also, there will be political implications as the collaborative efforts will be diminished, and the states will be involved in territorial controversies. The secondary implications will extend from the region to international relations. Global powers like the United States and China pursuing their interests could affect global financial and security frameworks.

In a research study published by the United States Bureau of Economic Research, major trading economies of the region are estimated to suffer GDP damage of over 12% if the intensified dispute blocks shipping in the vital waterways in the maritime region. The authors have also explored the scenario of the complete blockade of the South China Sea, which will force ships to take an alternative South Australia route. Small economies that are completely dependent on trade for economic growth like Taiwan, Hong Kong, and Singapore are more likely to be affected badly (Erbas, 2022).

The paper uses the data the Stockholm Institute of Peace Research Institute (SIPRI) maintained on military expenditure from 2011 to 2018 to explain the link between economic impact

and military spending. The authors conclude from the data that those countries that are economically more vulnerable to potential conflicts in the region will be spending more on defense and security.

The Strait of Malacca is an essential gateway for ships to enter the South China Sea. A short-term conflict in the sea would halt the vessels from entering or using the long alternative route. Long-term closure would affect the trade worth trillion dollars, disrupting the global supply chain. The Southeast Asian countries will suffer the most. The floods of 2011 in Thailand cost \$32 billion in their manufacturing sector. This damaged Thailand's hard-drive industrial sector, which affected universal hard drive supply, and the prices skyrocketed by 190%. Similarly, the long-term disruption of the South China Sea could have even worse implications than this, affecting the global supply chain (Dolven, Lawrence, & O'Rourke, 2021).

***The way Forward: Possible Solution to avoid conflicts in the region***

Since the South China Sea is one of the essential maritime trade routes, the conflict in the region will affect many territories. To avoid the implications of its blockade, certain steps needed to be taken so that many countries' economies are not affected, such as ***diplomatic engagement, confidence-building measures, assurance of compliance with international norms, and cooperation among regional countries.***

The contending parties must engage by diplomatic means and productive talks, and if needed, mediators should play their role to help regional contending countries reach a possible and viable solution. Confidence-building measures are also necessary for communication and mutual defense among the regional contenting parties. Also, the contending parties should comply with international norms and follow laws like the UN Convention on Law of the Sea (UNCLOS). Most importantly, regional cooperation will be essential for the possible solution. China and ASEAN countries need to cooperate in the region rather than engage in never-ending conflicts.

***Recommendation for China***

Beijing should strengthen its diplomatic ties at bilateral and multilateral levels with ASEAN countries by employing the instrument of economic diplomacy. The author has proposed a **Beijing-ASEAN Forum** for cooperation in the domains of socio-economics, security, and politics. Beijing should incentivize ASEAN countries by assisting them in developing industrial infrastructure, free and open trade followed by easy terms and conditions, and cultural and educational exchange programs to increase people-to-people contact. China has already developed appraisable economic and diplomatic ties with Asian countries, so if it succeeds in developing this Beijing-ASEAN Forum, at a broader level creation of an **Eastern Economic Block** led by Beijing would become possible. It would fulfill the PRC's dream of "**rejuvenation of the Chinese Nation**".

***Conclusion***

In conclusion, the significance of the South China Sea cannot be underestimated at any cost. It occupies a crossroads in regional and international trade and geopolitics. This could eventually lead to a conflicting situation in the region. The future of the South China Sea will be determined by the contending regional players, including China and global actors such as the United States, who have already been engaging in the South China Sea dispute in confrontation with its adversary, China. The presence of global actors and increasing animosity between China and other regional countries because of Beijing's increasingly aggressive nature may lead to high-scale conflict, as many geopolitics experts predict if World War 3 erupted from the South China Sea. Therefore, understanding the complex nature of the dispute, countries need to cooperate, and collective measures are necessary to avoid any future escalation that could disrupt the trade route. Implications are already discussed above. The future of the South China Sea demands wise anticipation and commitment by the contending parties for the region's stability which is needed for not only the economy of the region but to avoid the implications on the global economy.

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