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THESIS

**HOW WILL VIETNAM'S ECONOMIC RELATIONSHIP
AND DEPENDENCY ON CHINA AFFECT ITS RESPONSE
TO CHINA'S INCREASING THREAT TO ITS
SOVEREIGNTY?**

by

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ITS SOVEREIGNTY?**

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ABSTRACT

Vietnam's economic liberalization since the adoption of the Doi Moi has helped Vietnam's economy blossom. As a result of its economic liberalization, Vietnam has become more dependent on China for its economic growth and stability. This dependency has made it difficult for Vietnam to challenge China when its sovereignty is threatened. According to the World Bank, China is Vietnam's number one trading partner, with \$50 billion in trade commerce in 2013. By examining the importance of Vietnam's economic liberalization and its dependence on China, we can better understand how Vietnam will formulate its foreign policy with China and, in part, the United States.

Vietnam has modernized its military to close the gap between its military capabilities and China's. Vietnam has also increased its engagements with the United States, South Korea, Japan, India, Russia, and Australia in an attempt to hedge against China's increased aggression in the South China Sea. Meanwhile, Vietnam has opened up its seaports to the international community and begun upgrading Cam Ranh Bay seaport to become a repair facility to provide maintenance support for most naval vessels. Vietnam is using these strategies to better defend its sovereignty without impacting its economic relationship with China.

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LIST OF ACRONYMS AND ABBREVIATIONS

AFTA	ASEAN Free Trade Area
APEC	Asia–Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CCP	Chinese Communist Party
DOC	Declaration of Conduct
EEZ	Exclusive Economic Zone
EIA	Energy Information Administration
EPC	engineering, procurement, and construction
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
USNS	United States Naval Ship
USS	United States Ship
VCP	Vietnamese Communist Party
WTO	World Trade Organization

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I. INTRODUCTION

The United States and its allies have been concerned with China's economic and military rise since the end of the Cold War. Many Southeast Asian nations are also worried about China's influence and dominance in the region. Vietnam, in particular, is very leery of China's aggression in the South China Sea because it shares a long history with its northern neighbor. The two countries have fought each other over land and maritime territories, and China once ruled Vietnam for a millennium before Vietnam gained its independence.¹ Since the two countries reestablished diplomatic ties in 1991, Vietnam has become dependent on China for its economic growth and stability. This dependence has influenced Vietnam's response to China's increasing threat to its sovereignty. Vietnam's official responses to recent crises have mainly consisted of diplomacy with high-level talks as well as Hanoi's attempt to involve the international community for their support. This thesis explores how Vietnam's economic relationship and dependency on China will likely affect Vietnam's response to China's threat to its sovereignty.

A. IMPORTANCE

Vietnam's economic liberalization since the adoption of the *Doi Moi (Renovation)* policy in 1986 has helped Vietnam's economy blossom. As a result of its economic liberalization, Vietnam has become more dependent on China for its economic growth and stability. As Vietnam's economy grows more dependent on China, the cost of challenging China has also grown. This has made it very difficult for Vietnam to challenge China when Vietnamese sovereignty is threatened in the South China Sea. By examining the importance of Vietnam's economic liberalization and dependence on China for Vietnam's economic growth and stability, we can better understand how Vietnam will formulate its foreign policy with China and in part, the United States.

¹ Henry J. Kenny, *Shadow of the Dragon: Vietnam's Continuing Struggle with China and the Implication for United States Foreign Policy* (Washington, DC: Brassey's, 2002), 25.

In context of the current economy, the Vietnamese Communist Party (VCP) faces a dilemma: Vietnam must balance its interests in economic cooperation with China against Vietnamese interests in defending maritime territorial claims against China. China is Vietnam's number one trading partner, totaling \$50 billion in 2013.² Vietnam's trade with China is as high as the next two countries combined—Japan and South Korea, estimated at \$23.6 billion and \$20.8 billion, respectively.³ The balance of trade between Vietnam and China has also been a concern for the VCP; Vietnam has an estimated \$20 billion trade deficit with China.⁴ As China increases its aggression in the South China Sea, Vietnam is cautiously responding because Hanoi does not want to affect its economic relationship with Beijing. Vietnam has been formulating ways to defend its sovereignty in the South China Sea without provoking its northern neighbor. Vietnam's strategy has been to hedge against China that is multi-tiered, omni-directional.⁵

B. PROBLEMS AND HYPOTHESES

Vietnam's economic liberalization in the past twenty years has shaped its foreign policy towards China and influenced how the Vietnamese Communist Party (VCP) handled skirmishes that have threatened its sovereignty. Vietnam has several response options: 1) do nothing; 2) defend its sovereignty by using force, thus possibly severing its economic relationship with China; 3) preserve the status quo—the Vietnamese government will continue to use diplomacy and high-level talks to settle disputes; or 4) use other means that avoid a direct, head-on confrontation with Beijing, such as a hedging strategy. These options are not totally inclusive; there are other options available to Vietnam.

² Viet Tuan Dinh, Gabriel Demombynes, and Reena Badiani-Magnusson, *Taking Stock: An Update to Vietnam's Recent Economic Developments* (Hanoi: The World Bank, 2014), 21.

³ "Learn More about Trade in Vietnam," Observatory of Economic Complexity, accessed August 1, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

⁴ Thu Le Huong, *Vietnam: Straddling Southeast Asia's Divide* (Singapore: Institute of Southeast Asian Studies, 2014), 14.

⁵ Hiep Hong Le, "Vietnam's Hedging Strategy against China since Normalization," *Contemporary Southeast Asia* 35, no. 3 (2013): 337.

The key to Vietnam's response will be the economic relationship it has with China. Option one, not doing anything, will likely not be used. Vietnam has always responded in some form to China's aggression—from the use of military, as in the 1988 skirmish over the Johnson South Reef in the Spratly Islands, to the most recent oil rig incident when Hanoi used diplomacy and high-level talks to settle the crisis.⁶ Option two, use of force, will likely not be used due to potential for damaging the Vietnamese economy and possibly severing its economic relations with China. Additionally, China's military and naval superiority over Vietnam is another reason this option may not be considered; Vietnam will most likely lose any war at sea against its northern neighbor.⁷ Options three and four, preserving the status quo and indirect means, are the likely approaches Vietnam will use in response to China's increasing threats. Vietnam will likely use a strategy of diplomacy and high-level talks as well as hedging against China, both of these strategies will likely not affect Vietnam's economic relationship with China.

According to Hiep Hong Le, "economic interests play an important role in the formulation of Vietnam's foreign policy."⁸ Le continues to argue that promoting economic interests through foreign policy serves the interest of both the Vietnamese people and the VCP.⁹ This was true when *Doi Moi* was initially adopted and is especially true now that China is Vietnam's largest trading partner. Economic liberalization gave the Vietnamese people more opportunity to prosper and gave the VCP legitimacy by bringing its people out of poverty.

As Vietnam continues to prosper economically, so has its resolve for stability in the region. The Vietnamese leadership struggles to find a solution to the Chinese dilemma. On one hand, Vietnam's economy was bolstered by the Sino-Vietnamese

⁶ Jorn Dosch and Alexander L. Vuving, *The Impact of China on Governance Structures in Vietnam* (Bonn, Germany: German Development Institute, 2008), 9.

⁷ Zachary Abuza, "Vietnam Buckles under Chinese Pressure," last modified July 29, 2014, http://www.atimes.com/atimes/Southeast_Asia/SEA-01-290714.html.

⁸ Hiep Hong Le, "Vietnam's Domestic-Foreign Policy Nexus: *Doi Moi*, Foreign Policy Reform, and Sino-Vietnamese Normalization," *Asian Politics & Policy* 5, no 3 (2013): 387–392.

⁹ Ibid.

economic relationship. On the other hand, it will be difficult for Vietnam to back down from fighting for its sovereignty in the South China Sea. The VCP is cautious to not do anything that jeopardizes the economic relationship it has with China for fear of crippling the Vietnamese economy.

The foregoing discussion frames Vietnam's possible responses to Chinese aggression. One possibility is Vietnam's economic dependency will outweigh the sovereignty issue and Hanoi will not do anything that may hurt its economy. The other possibility is Vietnam's sovereignty and security concerns will trump the economic factor causing Vietnam to respond more aggressively to future crises and may use force if necessary to defend its sovereignty. This thesis concludes that Vietnam will likely lean towards the first possibility that its economy will outweigh the sovereignty concern.

C. LITERATURE REVIEW

This section focuses on two main ideas: the Sino-Vietnamese economic relationship and Vietnam's possible responses to increasing Chinese aggression. Regional experts and data from international organizations will be used to support the main ideas.

1. Vietnam's Economic Relationship with and Dependency on China

Vietnam's economy has steadily become more dependent on China for its growth and stability. In the early 1990s, Vietnam considered Japan and the Association of Southeast Asian Nation (ASEAN) its major trading partners; by 1996, its trade with Taiwan was still considerably higher than Beijing.¹⁰ In 1991, when Vietnam and China reestablished diplomatic ties, Vietnam's trade with China was estimated at \$32.2 million.¹¹ According to the World Bank, China has risen to be Vietnam's number one trading partner, making up 19 percent of Vietnam's total trade. The Chinese market

¹⁰ Joseph Y. S. Cheng, "Sino-Vietnamese Relations in the Early Twenty-First Century," *Asian Survey* 51, no. 2 (April 2011): 392.

¹¹ *Ibid.*

accounts for approximately 10 percent of Vietnam's exports and 28 percent of its imports; trade has increased to \$50 billion in 2013.¹²

In 2006, Brantly Womack, a professor at the Woodrow Wilson's Department of Politics, University of Virginia and the author of over 100 articles and chapters on Asian politics, argued that Vietnam "will not likely to become economically dependent on China."¹³ Vietnam's trade with China in 2006 was approximately \$9.6 billion.¹⁴ Seven years later, Hanoi's trade with Beijing has dramatically increased to \$50 billion.¹⁵ The world economy has changed and the Sino-Vietnamese economic relationship has also changed. Womack now argues that the asymmetric framework of trade between Vietnam and China will favor China, thus causing Vietnam's trade to be more dependent on China for its growth. He continues with the argument that Chinese goods fill the Vietnamese markets with China being the "chief source of Vietnam's machinery, computers, chemicals, and textiles."¹⁶ Additionally, China sells three times more fruit and vegetables to Vietnam than it buys.¹⁷ These two examples, Womack argues, in "economic capacity and structure, as well as in global weight," causes the "asymmetric framework for the economic relationship" between the two countries.¹⁸

Supporting Womack's argument, a recent World Bank Report stated that "imports from China are critical inputs for Vietnamese manufacturing exports, highlighting risks to the Vietnamese supply chain."¹⁹ This makes the Chinese import market very important for the Vietnamese's export market—Vietnam's import and export markets are

¹² Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 21.

¹³ Brantly Womack, *China and Vietnam: The Politics of Asymmetry* (Cambridge; New York: Cambridge University Press, 2006), 231.

¹⁴ "Import Origins of Vietnam," Observatory of Economic Complexity, accessed December 10, 2014, http://atlas.media.mit.edu/explore/tree_map/hs/import/vnm/show/all/2006/

¹⁵ Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 21.

¹⁶ Brantly Womack, "Vietnam and China in an Era of Economic Uncertainty," *The Asia-Pacific Journal* 36, no 2 (2009).

¹⁷ Ibid.

¹⁸ Womack, "Vietnam and China in an Era of Economic Uncertainty."

¹⁹ Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 32.

intertwined. The Report continued with Chinese foreign direct investment (FDI) commitments to Vietnam has risen sharply to approximately \$7.8 billion by the end of April 2014. Finally, the Report stated that Chinese companies are the main contractors to Vietnam in the form of Engineering, Procurement, and Construction (EPC) of many of the major projects in the power sector of Vietnam as well as being involved in the civil work of several important highways.²⁰ The Sino–Vietnamese economic dependency and relationship goes beyond the import-export market.

In another recent article, Le argues that Vietnam is heavily dependent on China for importation of “some of its major export industries, such as footwear, garments, textiles and furniture.”²¹ He continues with the argument that even though there are tensions between Hanoi and Beijing, and the “perennial trade deficit with China,” Vietnam considers “bilateral economic relations to be mutually beneficial and conducive to peace and cooperation between the two countries.”²² Le’s argument falls in line with Womack’s argument that Vietnam’s import market is vitally important to its export market causing Vietnam to be dependent on the Chinese market.

The VCP has consistently and actively sought bilateral dialogues with China at every level, even when its trade deficit is at \$20 billion.²³ Additionally, even with poorer quality or even “hazardous goods being imported from China couple with Chinese exploitation of Vietnamese natural resources,” show that Vietnam needs China for its economic growth and stability.²⁴ In 2009 alone, the VCP held approximately 290 meetings with its Chinese counterpart.²⁵ These meetings demonstrated Vietnam’s desire to remain close to China for their continued economic relationship.

²⁰ Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 32.

²¹ Hiep Hong Le, “Vietnam’s Strategic Trajectory: From Internal Development to External Engagement,” *Strategic Insights*, No. 59, Australian Strategic Policy Institute (2012): 6.

²² Ibid.

²³ Huong, *Vietnam*, 14.

²⁴ Ibid.

²⁵ Ibid.

Jorn Dosch and Alexander Vuving argue that Vietnam's location to China is also an important aspect to the economic relationship and dependency. Vietnam's proximity to a bigger, stronger neighbor and fellow communist regime helped the VCP to not follow in the same footsteps of its Eastern European brethren that fell when the Soviet Union collapsed.²⁶ Carl A. Thayer, a Vietnam expert with the University of New South Wales in Australia, also argues that the geo-strategic consideration is an important aspect to the economic relationship Vietnam shares with China. With the increase in trade between the two countries, Vietnam benefited greatly with the expansive upgrading and construction of infrastructure such as roads, bridges, and railways that were mostly funded by the World Bank and the Asian Development Bank.²⁷ These infrastructures link Vietnam, as well as Southeast Asia mainland, to China. Thus, Vietnam sees this link as the foundation for a closer relationship with China and provides an incentive for cooperative behavior.²⁸ Vietnam's geography and location are important factors with regards to its trade with China. Vietnam, especially its northern border provinces, acts as a conduit or trading station for Chinese products reaching the rest of ASEAN.²⁹

The significance of China on Vietnam's economy cannot be overstated. Vietnam has greatly benefited from the Sino-Vietnamese economic relationship, particularly from the lessons learned of Beijing's experiences. Vietnam did not incur the costs associated with repeating China's mistakes. Vietnam's economic model followed closely to the Chinese's economic roadmap that began in 1978.³⁰ The importance of China in terms of the Sino-Vietnamese relationship was simply stated by former VCP leader Le Kha Phieu, "If China succeeds in its reform, then we'll succeed. If China fails, we'll fail."³¹

²⁶ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 21.

²⁷ Carlyle A. Thayer, "The Tyranny of Geography: Vietnamese Strategies to Constrain China in the South China Sea," *Contemporary Southeast Asia* 33, no 3 (2011): 354.

²⁸ Ibid.

²⁹ Oliver Hensengerth, *Regionalism in China-Vietnam Relations: Institution-Building in the Greater Mekong Subregion*, Routledge Contemporary Asia Series 19 (London; New York: Routledge, 2010).

³⁰ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 11–24.

³¹ Ibid., 25.

2. Vietnam's Response to China's Threat

With China's military and economic rise, many of its smaller neighbors are concerned with how to handle the uncertainties of China's hegemonic rise. According to Hiep Hong Le, scholars have captured regional responses in different ways and formulated different policies because of the many different theories of international relations.³² Le gave an example from Aaron Freidberg who believes that states will balance against China because of the unstable multi-polarity for Asia in which power politics dominates.³³ On the other hand, Le followed up with an example from David Kang in which he finds that "Asian states do not appear to be balancing against...China. Rather they seem to be bandwagoning."³⁴ These two ideas have been criticized as being too one-dimensional and that there are other available options for states to respond to a rising power. Le continued the argument by quoting Amitav Acharya in which he referred balancing and bandwagoning as being "too limited to capture the range of choices a state has in responding to a rising power."³⁵ Finally, Le concluded that the best option for Vietnam would be to hedge against China, describing it as a "multi-tiered, omni-directional hedging strategy" in which states will use economic pragmatism, direct engagement, hard balancing, and soft balancing against a hegemonic power.³⁶

This thesis will lean towards Le's argument that Vietnam will likely use a hedging strategy with China. Vietnam will likely not bandwagon with China because of the long history the two countries share and because Vietnam was determined not to be a puppet for colonial powers as demonstrated in its fight for independence from China, France, and the United States. Another reason Hanoi will not bandwagon with Beijing is because of Vietnam's "sense of resentment towards China, emanating from historical legacies, has persisted within much of Vietnam's political elite and a significant part of

³² Le, "Vietnam's Hedging Strategy against China," 337.

³³ Ibid.

³⁴ Ibid., 338

³⁵ Ibid.

³⁶ Ibid., 335

the wider Vietnamese population.”³⁷ Finally, Vietnam learned its lesson from its over-dependency on one country, specifically the Soviet Union during the 1970s and 1980s. The fall of the Soviet Union may have taught the VCP a valuable lesson to not put all its eggs in one basket but to spread it amongst several key regional and international players. For these reasons, Vietnam will likely not bandwagon with China.

Vietnam’s economic relationship with China will be the main focus on its hedging strategy. Vietnam demonstrated that many of its past decisions concerning China were based on what or how Beijing will react. Vietnam welcomes U.S. engagements in the region but Hanoi “fears the Chinese reaction to Vietnam getting too close to America.”³⁸ Thayer concurs with this assessment arguing that “no major decision of any nature is made in Hanoi without taking Chinese interests and likely responses into account.”³⁹ This is one reason hedging is a good strategy for Vietnam.

The multi-tiered, omni-directional hedging strategy Vietnam will use is to maintain a balance between the United States and China. Vietnam will use its relations with the United States to hedge against China but will only go as far as not tilt the relationship too far to one side at the expense of China. According to Le, the only time Vietnam “might possibly tilt toward the United States is when China takes aggressive actions against Vietnam, such as invading Vietnamese-held islands” in the South China Sea.⁴⁰ Vietnam is in a good position because of its relationships to both China and the United States. Since Vietnam reestablished ties with both countries in the 1990s, its diplomatic and economic relationships have improved greatly; China is Vietnam’s number one importer while the United States is Vietnam’s number one export market.

Carl A. Thayer uses similar arguments to Le’s hedging strategy. Thayer identifies three strategies that Vietnam will use to manage its relations with China:

³⁷ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 10.

³⁸ Huong, *Vietnam*, 19.

³⁹ Thayer, “The Tyranny of Geography,” 5.

⁴⁰ Le, “Vietnam’s Strategic Trajectory: From Internal Development,” 8.

1. High-level party and state visits as a diplomatic tool to codify its relations with China;
2. Promoted multilateral institutions such as ASEAN, the ASEAN Regional Forum, ASEAN Plus Three, ASEAN Defense Ministers Meeting Plus Eight and the East Asia Summit; and
3. Self-help, or developing its own sufficient military capacity to deter China from using force.⁴¹

Thayer's first strategy of high-level party and state visits is comparable to Le's direct engagement. An example Thayer used was the lander border dispute in which China agreed with Vietnam to separate the issue from high-level consideration and to regulate the problem to technical working groups. As a result, "a treaty on the land border and agreement demarcating the Gulf of Tonkin were reached."⁴²

Thayer's second strategy duplicates Le's "multi-tiered, omni-directional hedging strategy" as previously mentioned. Thayer gives the example of when Vietnam chaired the ASEAN conference in 2010 to effectively internationalize issues of the South China Sea.⁴³ Additionally, Thayer mentioned that China is now discussing the "implementation of the 2002 Declaration of Conduct (DOC) of Parties in the South China Sea with the ASEAN counterparts in a joint working group."⁴⁴

Lastly, Thayer's third strategy of self-help is similar to Le's balancing strategies. Thayer argues that "self-help or developing its own sufficient military capacity to deter China from using force" is what Vietnam by modernizing its military only for defense purposes aimed at area denial.⁴⁵ Vietnam has also been renovating its Cam Ranh Bay seaport as a repair facility to host "all navies in the world in an effort to encourage the presence of foreign navies in the South China Sea."⁴⁶

⁴¹ Thayer, "The Tyranny of Geography," 4–5.

⁴² Ibid.

⁴³ Ibid., 5.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Thayer, "The Tyranny of Geography," 5.

As part of Le's hedging strategy, Alexander Vuving argues that there are two ways Vietnam can balance against China—externally and internally.⁴⁷ External balancing involves “building alliances with third parties on the international stage” and internal balancing is “where a country builds up its domestic strengths to enhance its preparedness.”⁴⁸ Additionally, theorists break balancing down in two other ways—hard and soft balancing. Hard balancing refers to “strategies by smaller states ‘to build and update their military capabilities, as well as create and maintain formal [and informal] alliances and counter-alliances’ to match the capabilities of the stronger power.”⁴⁹ Whereas, soft balancing is the “tacit balancing short of formal alliances, mainly in the form of limited arms build-up, *ad hoc* cooperative exercises, or collaboration in regional or international institutions.”⁵⁰ All of these definitions fall in line with Le's hedging strategy for Vietnam.

D. METHODS AND SOURCES

Chapter two will be devoted to describing and analyzing Vietnam's economic dependence on China and how it has risen as a result of economic liberalization. Additionally, the chapter will go into more detail of Vietnam's *Doi Moi* policy and how Vietnam was transformed into one of the fastest growing economies in the world. Vietnam's economic dependency on China will force it to settle all future conflicts as diplomatically and as quickly as possible so the impact on its economy will be minimized by any tension. Data will be collected from the World Bank as well as other scholarly resources in an attempt to explain how Vietnam's economic liberation has transformed the country into a destination for international businesses and foreign investments. Finally, chapter two will explain how Vietnam's economic liberalization increased its

⁴⁷ Alexander L. Vuving, “Strategy and Evolution of Vietnam's China Policy: A Changing Mixture of Pathways,” *Asian Survey* 46, Issue 6 (2006): 807.

⁴⁸ Vuving, “Strategy and Evolution of Vietnam's China Policy,” 807.

⁴⁹ Le, “Vietnam's Hedging Strategy against China,” 335–336.

⁵⁰ *Ibid.*, 336.

dependence to China while contributing to the Vietnamese prosperity, and how Vietnam's prosperity is dependent on access to the Chinese market.

Chapter three will examine the increasing Chinese challenge to Vietnam's maritime territorial claims and how the VCP faced increase pressure to respond militarily to China's actions. Vietnam has responded by hedging against its northern neighbor. The strategy includes modernizing its military and increasing its engagement with the international community, including the United States, Japan, India, South Korea, and Australia. Vietnam's economic dependence as well as the asymmetric military and naval capabilities with China has constrained Hanoi's ability or willingness to take military actions against Beijing. This paper will use experts and theorists to argue that Vietnam will continue to use diplomacy and high-level talks to settle future disputes with China. Hanoi will formulate a strategy of hedging to better defend itself from continued Chinese aggression without provoking Beijing.

The last chapter will tie in Vietnam's economic liberalization with its foreign policy with China and how potentially the United States will have an influence to it. Vietnam will attempt to lessen its dependence with China by expanding its market to the international community and by increasing its trade with its strategic partners. While the U.S.–Vietnamese relationship has gotten stronger since the 1990s and the United States is Vietnam's number one export market, Vietnam will choose economic stability it has with China over closer ties with the United States. However, Hanoi will also encourage the United States and the international community to help calm and settle future conflicts with China and would prefer to use diplomacy rather than military force for future disputes.

E. THESIS OVERVIEW

This thesis will explore Vietnam's economic liberalization and how Vietnam's economic dependence on China will make it difficult for the VCP to respond with military force to defend its sovereignty. Vietnam's relationship and increased engagement with the United States and other countries is one solution to the Chinese problem. Additionally, Vietnam is modernizing its military to close the gap between the two countries' military capabilities and is updating Cam Ranh Bay as a maintenance depot for ships of all nations. Hanoi has also expanded its markets in an attempt to lessen its dependence on Beijing. These courses of action are Vietnam's best strategy to deter China's aggression while attempting to lessen the impact on its economic relationship. Vietnam's economic liberalization has influenced how Vietnam formulates its foreign policy towards China. While Vietnam has increased its trade with its strategic partners in an attempt to lessen its dependence on China, Hanoi does not want to lose the economic relationship it has with Beijing and is dependent on the Chinese market for its continued economic growth and stability.

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II. VIETNAM'S ECONOMIC RELATIONSHIP WITH AND DEPENDENCY ON CHINA

This chapter discusses Vietnam's economic relationship with and dependency on the Chinese market for Vietnam's continued growth and stability. The chapter is divided into four sections based on the following timelines: post-Vietnam War, Cold War Apex, post-Cold War, and the present. Each section will discuss Vietnam's economy and how it grew increasingly dependent on the Chinese market. Vietnam's economy grew from being one of the poorest countries in the world to a booming economy that is on par with many industrialized countries of the world.

A. POST-VIETNAM WAR

After the fall of Saigon in 1975, the Vietnamese economy was decimated as communist North Vietnam struggled to merge the two countries into one. According to Martin Rama, "Vietnam was a country with a dilapidated infrastructure and two dysfunctional and disconnected economies."⁵¹ Furthermore, Vietnam's economy continued to decline through the 1980s from fighting back to back wars. Vietnam's decade-long invasion and occupation of Cambodia and fighting the Chinese were factors that also destroyed the Vietnamese economy. Another reason for Vietnam's economic despair was that it continued to have a large military force on its northern border; the Vietnamese government was afraid of another Chinese invasion. The cost of maintaining the military buildup on the northern border affected Vietnam's economy as well.

The Sino-Vietnamese relationship soured during the 1970s when Vietnam grew closer to the Soviet Union. Then in 1978, Vietnam invaded Cambodia and removed the Chinese-supported Pol Pot government. Approximately two months later, China invaded northern Vietnam in retaliation. A short but fierce battle raged on for about a month before Chinese forces retreated back to their border. Fighting and skirmishes continued

⁵¹ Robert E. Looney, ed., *Handbook of Emerging Economies*, Routledge International Handbooks (New York: Routledge, 2014), 339.

through the 1980s at Vietnam's northern border; China continued to harass the Vietnamese army with mortar shells and artillery rounds, as well as with mines released into rivers flowing into Vietnam.⁵²

There were many other factors that also contributed to the demise of the Vietnamese economy in the 1980s. They included severe weather conditions affecting agriculture production, bureaucratic mismanagement and corruption, eliminating private ownership of businesses, and isolation from the international community for its invasion of Cambodia.⁵³ Isolation from the international community resulted in little to no access of reconstruction funds, a lack of foreign direct investment (FDI), and embargos placed on the country.⁵⁴

B. COLD WAR APEX

In 1985, Vietnam was ranked as one of the world's top five poorest countries with a gross domestic product (GDP) per capita of approximately \$130 per year.⁵⁵ With the majority of Vietnamese people living in poverty, the Vietnamese Communist Party (VCP) needed to revitalize the country's economy for the country to survive. At the same time, the Vietnamese population was also losing faith in the VCP, and the regime's survival was at stake.⁵⁶ In 1986, the Sixth National Congress of the VCP adopted *Doi Moi*, a renovation plan or policy with the goal of creating a socialist-oriented market economy to lift the country out of poverty. Though *Doi Moi* was not an overnight success, it laid the foundation that took the country out of poverty and into one of the fastest growing economies in the world.⁵⁷ According to Yoshiharu Tsuboi, "it was a

⁵² Le, "Vietnam's Domestic-Foreign Policy Nexus" 396–397.

⁵³ Ronald J. Cima (ed.), *Vietnam: A Country Study*, Washington: GPO for the Library of Congress (1987), accessed October 14, 2014, <http://countrystudies.us/vietnam/>.

⁵⁴ Ibid.

⁵⁵ Paul Glewwe, "An Overview of Economic Growth and Household Welfare in Vietnam in the 1990s," ed. Paul Glewwe, Nisha Agrawal, and David Dollar (The International Bank for Reconstruction and Development/The World Bank, 2004), 1.

⁵⁶ Le, "Vietnam's Domestic-Foreign Policy Nexus," 387–388.

⁵⁷ "Vietnam," The World Bank, accessed October 3, 2014, <http://www.worldbank.org/en/country/vietnam>.

policy that abandoned doctrinaire socialist theories, introduced a market economy, and opened the country to the global economy.”⁵⁸ Hanoi shifted its priority on improving its relationship with China to begin its economic recovery.

During the 1980s, the Sino–Vietnamese relationship remained tense as the two countries continued to fight sporadically with each other at their border. Even with unrelenting harassments originating from China, trade continued between the two countries, especially in Vietnam’s northern region. Between 1985 and 1990, consumer goods in northern Vietnam, according to Oliver Hensengerth, “changed from serious shortage to abundance as cheap Chinese goods flooded across the border into Vietnam...and posed a threat to Vietnamese light industry and led to bankruptcy of Vietnamese producers.”⁵⁹ Fortunately, after Vietnam reestablished diplomatic relations with China, Vietnam’s economy began to grow.

The 1980s brought about many changes to the international community. Countries that were once enemies are now friends. The relationship between China, the Soviet Union, and the United States changed as well. Additionally, Vietnam’s relationships with these three countries also changed. President Mikhail Gorbachev’s Vladivostok speech in July 1986 marked the accelerated change in the Sino-Soviet relationship of which Gorbachev made “rapprochement with China a diplomatic priority.”⁶⁰ Furthermore, some scholars believe the Malta Conference in 1989 was the catalyst that thawed the Cold War between the U.S. and the Soviet Union.⁶¹

The changes in Sino-Soviet–U.S. relationships forced Vietnam to evaluate its own relationship with these three countries to determine what was in its best interests. Hiep

⁵⁸ Yoshiharu Tsuboi, “Twenty Years after the Adoption of the Doi Moi Policy,” (Tokyo, Japan: Waseda University), February 2007.

⁵⁹ Hensengerth, *Regionalism in China-Vietnam Relations*, 131.

⁶⁰ Dimitri K. Simes, “Gorbachev: A New Foreign Policy?” *Foreign Affairs*, accessed September 1, 2014, <http://www.foreignaffairs.com/articles/41714/dimitri-k-simes/gorbachev-a-new-foreign-policy>.

⁶¹ Joshua R. Itzkowitz Shiffrin, “The Malta Summit and US-Soviet Relations: Testing the Waters Amidst Stormy Seas,” Wilson Center, accessed September 1, 2014, <http://www.wilsoncenter.org/publication/the-malta-summit-and-us-soviet-relations-testing-the-waters-amidst-stormy-seas>.

Hong Le argued that the “changes in the international conditions began to influence the VCP’s worldview and its perception of national interests, as well as its definition of ‘friends’ (*ban*) and ‘enemies’ (*thu*).”⁶² Vietnam was under tremendous pressure from the Soviet Union to repair its ties with China.⁶³ The Soviet Union had been a key financial and military supporter of North Vietnam dating back to the 1940s when the North Vietnamese fought the French in the First Indochina War; Soviet aid continued through the Vietnam War and into the 1980s.⁶⁴

Besides the introduction of *Doi Moi*, the VCP needed another solution to improve the Vietnamese economy: mending its relations with China as quickly as possible. Hanoi made several important concessions to Beijing in order to accelerate normalization. It first began by withdrawing its forces from Cambodia in the late 1980s. In 1991, Vietnam signed the Paris Peace Accord, effectively ending the war in Cambodia; Vietnam normalized its relationship with China shortly after. Reestablishing diplomatic ties with China resulted in economic growth and poverty reduction in Vietnam.⁶⁵

Domestically, Vietnam’s policies and laws were passed or changed to create business growth and to attract foreign investors. These changes made it easier for companies to conduct business in Vietnam. Additionally, Vietnam expanded its trading partners and integrated itself into the international economy. Finally, *Doi Moi* was the foundation that bolstered Vietnam’s economy. *Doi Moi* can be viewed as the cornerstone of Vietnam’s economic relationship with China and the United States; China is Vietnam’s number one importer while the United States is Vietnam’s number one export market.⁶⁶

⁶² Le, “Vietnam’s Domestic-Foreign Policy Nexus,” 395.

⁶³ Carlyle A. Thayer, “Sino-Vietnamese Relations: The Interplay of Ideology and National Interest,” *Asian Survey* 34, no 6 (Jun 1994): 514–515.

⁶⁴ “Soviet Aid to North Vietnam,” GlobalSecurity.org, accessed October 14, 2014, <http://www.globalsecurity.org/military/world/vietnam/hist-2nd-indochina-ussr.htm>.

⁶⁵ “Data: Vietnam,” The World Bank, accessed June 1, 2014, http://data.worldbank.org/country/vietnam#cp_fin.

⁶⁶ “Learn More about Trade in Vietnam,” Observatory of Economic Complexity, accessed August 1, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

To attract foreign investors, the Vietnamese government initially adopted the Foreign Direct Investment Law in 1987. The law has since been modified to make it more attractive for foreign investors to invest in Vietnam. The law gave substantial tax breaks for foreign businesses operating in Vietnam, permitted 100 percent foreign ownership of business, and guaranteed unlimited return on investment.⁶⁷ With the changes in the way Vietnam conducted its domestic and foreign businesses, the poverty rate sharply declined and helped shape Vietnam into a viable economic player in the international arena.

Domestically, Vietnam's policies and laws were passed or changed to create business growth and to attract foreign investors. These changes helped level the playing field for companies conducting businesses in Vietnam. Additionally, Vietnam expanded its trading partners and integrated itself into the international economy. Finally, *Doi Moi* was the foundation that bolstered Vietnam's economy. *Doi Moi* can be viewed as the cornerstone of Vietnam's economic relationship with China and the United States; China is Vietnam's number one importer while the United States is Vietnam's number one export market.⁶⁸

In order for Vietnam's economy to grow, the VCP needed to make its market competitive. In 2005, the VCP passed the Enterprise and Investment Laws to remove all the legal terms that discriminate between state-owned versus private companies and domestic versus foreign companies.⁶⁹ These two laws established the requirements for all businesses wanting to operate in Vietnam without the distinction of ownership.⁷⁰ In addition to making it easier to conduct businesses in Vietnam, the Vietnamese government signed several trade agreements with the international community to help

⁶⁷ Hau Thi Trung Chu and Paul M. Dickie, *Economic Transition in Viet Nam: Doi Moi to WTO* (Hanoi, Vietnam: Asian Development Bank, 2006).

⁶⁸ "Learn More about Trade in Vietnam," Observatory of Economic Complexity, accessed August 1, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

⁶⁹ "Law of Enterprises," Vietnam National Assembly, accessed September 1, 2014, [http://www.vietnamlaws.com/freelaws/Lw60na29Nov05Enterprises\[10Apr06\].pdf](http://www.vietnamlaws.com/freelaws/Lw60na29Nov05Enterprises[10Apr06].pdf); "Law of Investment," accessed September 1, 2014, [http://www.vietnamlaws.com/freelaws/Lw59na29Nov05CIL\[10Apr06\].pdf](http://www.vietnamlaws.com/freelaws/Lw59na29Nov05CIL[10Apr06].pdf).

⁷⁰ Ibid.

promote its trade. Beginning in 1992, Vietnam signed a trade agreement with the European Union (EU). It then joined the Association of Southeast Asian Nations (ASEAN) and the ASEAN Free Trade Area (AFTA) in 1995. It became a member of the Asia-Pacific Economic Cooperation (APEC) in 1998. Next, Vietnam signed the Bilateral Trade Agreement with the U.S. in 2000. Finally, Hanoi became a member of the World Trade Organization (WTO) in 2006, thus integrating itself into the international economy.

C. POST-COLD WAR

The Soviet Union was Vietnam's main supporter of military and financial aid. It previously provided Vietnam annual assistance of approximately one billion rubles (approximately \$36.2 million).⁷¹ Additionally, trade between the two countries, which had peaked at two billion rubles (approximately \$72.5 million) annually, dropped dramatically to approximately one-tenth of the original level; all Soviet aid to Vietnam stopped in 1991.⁷² Vietnam needed to look elsewhere for support and China's economic reforms looked like a promising solution for the VCP.⁷³

Since 1991, the Sino-Vietnamese trade grew significantly for the Vietnamese market, especially for the northern region near the border.⁷⁴ Chinese products inundated the region with cheaper and better products that could be produced locally or purchased elsewhere.⁷⁵ The Chinese products produced three major problems to the Vietnamese market. First, they created a balance of payments because there was no Vietnamese product to sell in return, and Vietnam was concerned of the siphoning of its resources going into China because Hanoi was mainly exporting produce and raw material to China. Second, many of the Vietnamese producers were devastated because they could not compete with the Chinese imports which resulted in the VCP attempting to protect its

⁷¹ Cheng, "Sino-Vietnamese Relations in the Early Twenty-first Century," 384.

⁷² Ibid.

⁷³ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 11–24.

⁷⁴ Womack, *China and Vietnam: The Politics of Asymmetry*, 215.

⁷⁵ Ibid.

industries against Chinese competition. Third, the black market and smuggling operations were widespread equaling in value to the official trade.⁷⁶

Conversely, Chinese products undercut the local monopolies and spurred local producers to be more customer-oriented, thus satisfying the demands.⁷⁷ It also helped filled the void when items were inadequately produced in the region, such as beer. Prior to the importation of Chinese beer, many of the local shops had difficulty satisfying the demands resulting in consumers going to the black market and paying up to four times the price of a bottle of beer.⁷⁸ The importation of Chinese beer quenched the demands of the consumers and help reduced the black market operations.

Vietnam closely monitored China's economic reforms and its experiments and experiences and borrowed what worked for the Chinese.⁷⁹ China's economic reforms became a model for the Vietnamese to emulate, thus the Sino-Vietnamese economic relationship was crucial for Vietnam to succeed. It benefited Hanoi greatly from Beijing's experience and the lessons learned from China helped dramatically reduce Hanoi's cost of repeating mistakes that China made and reaping the benefits when China succeeded.⁸⁰ Reiterating the importance of China's reforms on the Vietnamese economy, recall, again, the words of VCP leader Le Kha Phieu: "If China succeeds in its reform, then we'll succeed. If China fails, we'll fail."⁸¹

⁷⁶ Womack, *China and Vietnam: The Politics of Asymmetry*, 215.

⁷⁷ Ibid., 216.

⁷⁸ Ibid., 215–216.

⁷⁹ Cheng, "Sino-Vietnamese Relations in the Early Twenty-First Century," 383.

⁸⁰ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 25.

⁸¹ Ibid.

D. PRESENT

The economic relationship between Hanoi and Beijing has helped both economies grow over the last 25 years; however, Vietnam's economic prosperity has become dependent on the Chinese market for its continued growth and stability. Vietnam's trade with China grew from \$32.2 million in 1991 to an estimated at \$50 billion in 2013 alone.⁸² Vietnam's trade with China is as high as the next two countries combined trade with China—Japan and South Korea, estimated at \$23.6 billion and \$20.8 billion, respectfully.⁸³ Vietnam was ranked 57th out of approximately 200 countries, in terms of GDP, according to the World Bank in 2013.⁸⁴ Vietnam's economic growth is a great success story for a country that was once considered one of the world's poorest countries in the world.

The *Doi Moi* policy has brought about a remarkable turnaround for the country in terms of GDP growth and stability, expanding its foreign trade, increasing its attraction for direct foreign investments, and decreasing its poverty rate.⁸⁵ Vietnam's *Doi Moi* policy opened its doors to western markets, and its economy grew stronger. During the next twenty years, from 1986–2006, the average economic growth rate of Vietnam was 7.1 percent, making it one of the fastest growing economies in the world.⁸⁶ Vietnam's GDP grew from \$26.3 billion in 1986 to \$66.4 billion in 2006; less than ten years later, it almost tripled to \$171.4 billion in 2013.⁸⁷ There are several reasons for *Doi Moi*'s success, which helped transform Vietnam's economy to the status it is today. Domestically, the VCP added or modified its laws to attract foreign investors and made it

⁸² Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 25.

⁸³ Cheng, "Sino–Vietnamese Relations in the Early Twenty-First Century," 385; Observatory of Economic Complexity, accessed 1 Aug 14, <http://atlas.media.mit.edu/profile/country/vnm/>.

⁸⁴ "Data: Vietnam," The World Bank, accessed August 1, 2014, <http://databank.worldbank.org/data/download/GDP.pdf>.

⁸⁵ Thanh Thi Vo and Doung Anh Nguyen, "Vietnam after Two Years of WTO Accession: What Lessons Can Be Learnt?" *ASEAN Economic Bulletin* 26, no. 1 (April 2009): 115–116.

⁸⁶ Khoun M. Vu, "Economic Reform and Performance: A Comparative Study of China and Vietnam," *China: An International Journal* 7, no 2 (Sep 2009): 206.

⁸⁷ "Data: Vietnam," The World Bank, accessed September 1, 2014, <http://data.worldbank.org/country/vietnam>.

easier for businesses to operate in the country. Internationally, Vietnam broadened its market base and reestablished relations with its former enemies, particularly China and the United States.

Since Vietnam's establishment of the *Doi Moi*, Vietnam has risen to be a strong and viable country for foreign investments. Hanoi opened its doors to the international community and Foreign Direct Investment (FDI) began flowing into the country. Vietnam's economic liberation has proven that even the poorest of countries can make a turnaround. The Sino–Vietnamese economic relationship has blossomed since the two countries reestablished diplomatic ties in 1991. Figures 1 and 2 identify the top ten countries trading with Vietnam and show the importance of the Sino–Vietnamese economic relationship as well as the U.S.–Vietnamese trade relationship.

1	USA	 United States	\$17,704,358,753.41	16%
2	JPN	 Japan	\$14,045,993,064.14	13%
3	CHN	 China	\$13,738,699,326.53	12%
4	DEU	 Germany	\$6,359,226,991.79	5.7%
5	KOR	 South Korea	\$5,620,760,876.97	5.0%
6	HKG	 Hong Kong	\$4,164,394,596.37	3.7%
7	MYS	 Malaysia	\$3,996,363,544.69	3.6%
8	GBR	 United Kingdom	\$3,827,765,523.87	3.4%
9	FRA	 France	\$3,321,614,392.45	3.0%
10	AUS	 Australia	\$3,161,513,503.94	2.8%

Figure 1. Countries to which Vietnam Exports (2012)⁸⁸

⁸⁸ “Learn More About Trade in Vietnam,” Observatory of Economic Complexity, accessed August 1, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

1	CHN	 China	\$28,567,056,225.62	28%
2	KOR	 South Korea	\$15,216,963,546.43	15%
3	JPN	 Japan	\$9,591,933,804.15	9.5%
4	SGP	 Singapore	\$5,905,263,119.08	5.9%
5	THA	 Thailand	\$5,377,157,643.71	5.3%
6	MYS	 Malaysia	\$3,394,855,679.96	3.4%
7	HKG	 Hong Kong	\$3,332,263,795.12	3.3%
8	IND	 India	\$3,303,036,817.43	3.3%
9	USA	 United States	\$2,967,170,934.23	2.9%
10		 Other Asia	\$2,624,449,478.63	2.6%

Figure 2. Countries from which Vietnam Imports (2012)⁸⁹

The two tables demonstrate Vietnam's need for the economic relationship it has with China and how Vietnam is dependent to its northern neighbor for its economic growth and stability. Additionally, Chinese imports are vitally important to Vietnam's export market.

The economic relationship between the two countries has helped both economies grow. The downside to this economic dependency is that Vietnam continues to need this economic relationship with China for it to continue to grow. The recent crisis in the South China Sea concerning the oil rig *Haiyang Shiyu 981* near the Paracel Islands has put tremendous pressure on the VCP to ease the conflict as quickly as possible. The Vietnamese's protesting of China's aggression has hurt its economy. Many of the Chinese and foreign-owned businesses were closed during the protests and their Vietnamese suppliers and manufacturers felt the economic pain as well. Though the economic relationship between Vietnam and China is important to both countries, China cannot use Vietnam's dependence on its economy to threaten or punish it for the way Hanoi was responding to the oil rig incident. According to Jason Morris-Jung, a Vietnam expert at the Institute of Southeast Asian Studies, "The thing with using economics as a

⁸⁹ "Learn More about Trade in Vietnam," Observatory of Economic Complexity, accessed August 1, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

weapon is that it is artillery fire in both directions. If you punish a seller in Vietnam, you also hurt a buyer in China, and vice versa.”⁹⁰ By punishing Vietnam economically, China will also penalize its people and its economy will be affected, though not as bad as its Vietnamese counterparts.

With regard to FDI, Vietnam benefited more for its proximity to China than by learning from the Chinese model.⁹¹ Many foreign investors went to Vietnam to diversify their manufacturing base because they feared tensions in their own countries’ relations with Beijing may adversely affect their businesses in China.⁹² In general, Vietnam welcomes FDI in most sectors but was initially hesitant concerning “even small-scale investment from China, even though Hong Kong and Taiwan were among its top investors.”⁹³ The Sino–Vietnamese turbulent relationship has resulted in lack of trust for the Vietnamese government. Additionally, land border and maritime issues were still unresolved during the early 1990s and the sovereignty issues in the South China Sea are still unsettled today.

The Vietnamese leadership continually looked up to the Chinese for support and guidance with its economic reforms. In 2000, over a dozen of the VCP’s most-senior officials visited China for an “unpublicized lesson on how to reform a socialist economy without losing party control.”⁹⁴ Though Vietnam’s sovereignty issues are still unresolved, Vietnam will continue to look towards China for its economic growth. Vietnam will favor its economic relationship with China over its sovereignty and security concerns in the South China Sea. The only exception would be if China attacks territories that are currently controlled or occupied by the Vietnamese.

⁹⁰ Chris Brummitt, “China-Vietnam Tension May Be Costly,” *Boston Globe*, last modified June 4, 2014, <http://www.bostonglobe.com/business/2014/06/03/sabers-rattle-vietnamese-businesses-fret/VqMn8BzOauDHOikiRKCcKL/story.html>.

⁹¹ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 25.

⁹² Ibid.

⁹³ Womack, *China and Vietnam*, 216.

⁹⁴ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 25.

Figure 3 shows Vietnam's trade with China has exponentially exploded the last twenty years and it appears there is no limit of the growth potential with its trade to China. In 1991, Vietnam imported an estimated \$10.6 million from China.⁹⁵ By 2012, China imported an estimated \$28.6 billion into the Vietnamese economy; the Chinese market made up almost 28.4 percent of Vietnam's total import.⁹⁶ The table depicts a trend that shows Vietnam's continuing dependence on its trade with China and the trade gap is growing wider as well. Although Vietnam is an important trading partner to China, Beijing is not as dependent on the Vietnamese market as the Chinese market is to Hanoi. China's export to Vietnam only makes up 1.35 percent of its total export. China's number one export market is the US, making up almost 18.8 percent with approximately \$400 billion in total export.⁹⁷

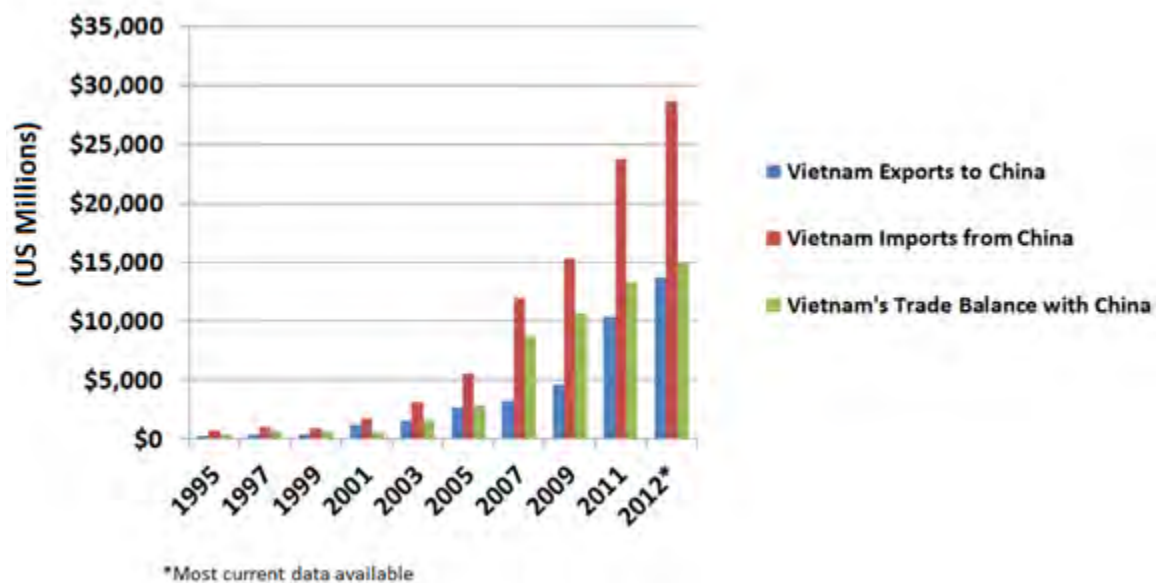


Figure 3. Vietnam–China Trade⁹⁸

⁹⁵ Cheng, “Sino–Vietnamese Relations in the Early Twenty-First Century,” 394.

⁹⁶ “Import Origins of Vietnam,” Observatory of Economic Complexity, accessed October 20, 2014, http://atlas.media.mit.edu/explore/tree_map/hs/import/vnm/show/all/2012/.

⁹⁷ Ibid., accessed November 21, 2014.

⁹⁸ “Export Destinations of China,” Observatory of Economic Complexity, accessed November 21, 2014, http://atlas.media.mit.edu/explore/tree_map/hs/export/chn/show/all/2012/.

The substantial growth to the Vietnamese economy has been bolstered by the Sino–Vietnamese economic relationship and has helped Vietnam become an important market in the region and around the world. The Sino–Vietnamese economic relationship has made it difficult for the VCP to pursue any actions that interferes with this relationship. As mentioned previously concerning the oil rig *Haiyang Shiyou 981*, Vietnam used diplomacy as well as encouraged the international community to apply pressure to the Chinese government to remove the oil rig. Vietnam did not directly confront China by using military force. Though there were small skirmishes at sea with fishing vessels ramming one another and riots across Vietnam, there were no reports of the Vietnamese government attempting to physically stop China from conducting exploratory drilling for oil and natural gas within Vietnam’s Exclusive Economic Zone (EEZ).

The surrounding waters adjacent to the Paracel Islands are rich in natural resources and the potential oil and gas reserve under the seabed is tremendous. According to the U.S. Energy Information Administration (EIA), the South China Sea is critical to the world trade route and has a potential source of hydrocarbons, particularly natural gas. The EIA estimates the South China Sea contains approximately 11 billion barrels of oil and 190 trillion cubic feet of natural gas in proved and probable reserves.⁹⁹ Hanoi wants to expand offshore production in the South China Sea as a way to meet the domestic demand as well as contributing to state finances. Besides the natural resources off Vietnam’s coast, Vietnam is concern with the encroachment of China in what it sees as a violation to its sovereignty.

Vietnam has been expanding its markets in order to grow. It understands that in order to do this, Hanoi will not limit Chinese imports because as the Vietnamese market grows, so will the increase of Chinese imports.¹⁰⁰ Additionally, Vietnam’s expanding market is also a strategy the VCP is using in an attempt to lessen the dependency of the Chinese market. Just recently, Vietnam and India reaffirmed their Strategic Partnership

⁹⁹ “South China Sea: Analysis Brief,” U.S. Energy Information Administration, last modified February 7, 2013, http://www.eia.gov/countries/regions-topics.cfm?fips=scs_.

¹⁰⁰ Cheng, “Sino–Vietnamese Relations in the Early Twenty-First Century,” 394–395.

that would “lead to peace, prosperity and stability for people of both countries,” according to the Prime Minister of India official website.¹⁰¹ India also approved \$100 million Line of Credit to the Vietnamese government for defense procurement.¹⁰² Additionally, India offered \$300 million credit line to Vietnam for trade.¹⁰³ Hanoi is using the strategic partnership with India in hopes that this will lead to increase trade with New Dehli and lessen its dependence with Beijing. According to Thayer, the bilateral trade between Vietnam and India has already surpassed the 2015 mark of \$7 billion and will likely be raised. Additionally, Thayer continued with “the sub-text of India-Vietnam economic cooperation is to lessen Vietnam’s dependency on China.”¹⁰⁴

Comparing Vietnam and China in terms of composition of trade, Vietnam has a comparative advantage in mineral and agricultural products while China has the advantage in industrial products.¹⁰⁵ The relationship between the two countries shows the complementarity in product categories that there is substantial intra-industry trade, and that Vietnam and China are closely linked in international production chains.¹⁰⁶ China exports capital goods and industrial intermediate products to Vietnam where Beijing exploits cheap labor, while Hanoi exports finished products internationally, mainly to the U.S. and EU. The EU’s market is second only to the United States in Vietnamese exports.¹⁰⁷

¹⁰¹ “Joint Statement on the State Visit of Prime Minister of the Socialist Republic of Vietnam to India,” Prime Minister of India, last modified October 28, 2014, http://pmindia.gov.in/en/news_updates/joint-statement-on-the-state-visit-of-prime-minister-of-the-socialist-republic-of-vietnam-to-india/.

¹⁰² “Joint Statement on the State Visit of Prime Minister,” last modified October 28, 2014.

¹⁰³ “India Offers \$300 million Credit Line to Vietnam for Trade,” *Economic Times*, October 28, 2014, http://articles.economictimes.indiatimes.com/2014-10-28/news/55521416_1_india-and-vietnam-business-leaders-india-today.

¹⁰⁴ Carlyle A. Thayer, “How Vietnam Woos China and India Simultaneously,” *Diplomat*, accessed October 28, 2014, <http://thediplomat.com/2014/10/how-vietnam-woos-china-and-india-simultaneously/?allpages=yes&print=yes>.

¹⁰⁵ Cheng, “Sino–Vietnamese Relations in the Early Twenty-First Century,” 394.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

Brantly Womack argues that the asymmetric framework of trade between Vietnam and China favors China resulting in the Vietnamese market being dependent on the Chinese market for its growth and stability. Vietnam trade with China has dramatically increased to \$50 billion and the trend appears it will increase substantially in the near future. Table 5 above shows Chinese imports have increased at a faster rate than Vietnamese exports to China. Womack continues his argument with “the disparity between the economies of China and Vietnam is accentuated by an imbalance between imports and exports. China is easily Vietnam’s number one source of imports, equal to 79 percent of imports from all of ASEAN.”¹⁰⁸ Continuing the argument, Womack gives the example of how Vietnam exports 70 percent of its rubber to China but it buys approximately two-thirds more rubber products from China than it sells.¹⁰⁹ This hurts the Vietnamese economy because it reinforces Vietnam’s continued dependency on the Chinese market for its growth and stability. The speed of Vietnam’s transformation from being one of the poorest countries in the world to a middle-income country was amazing. In 2002, Vietnam was considered a highly indebted poor country. Less than a decade later, in 2010, it was borrowing from the International Bank of Reconstruction and Development, a sign of international creditworthiness.¹¹⁰

E. CONCLUSION

Vietnam has continually looked to China for its economic growth through trade, FDI, and the lessons learned from China’s economic roadmap. Hanoi has also looked to Beijing for support and guidance in terms of economic reforms. Accordingly, Vietnam has “actively sought Chinese advice and guidance particularly on economic matters and especially the question as to how to reform a socialist economy without losing party control.”¹¹¹ Furthermore, Vietnam’s economic liberalization since the adoption of the *Doi Moi* has helped the Vietnamese economy flourish and become an important market

¹⁰⁸ Womack, “Vietnam and China in an Era of Economic Uncertainty.”

¹⁰⁹ Ibid.

¹¹⁰ Looney, *Handbook of Emerging Economies*, 339.

¹¹¹ Dosch and Vuving, *The Impact of China on Governance Structures in Vietnam*, 29.

for the region and the world. As a result of its economic liberalization, Vietnam has become more dependent on China for its economic growth and stability. As Vietnam's economy grows more dependent on China, so has the cost of challenging China and has made it very difficult for Hanoi to challenge Beijing when China encroaches on its sovereignty in the South China Sea. Vietnam's economic liberalization has given the Vietnamese people prosperity but it has also led to an economic dependence on China; as a result, the Vietnamese government faces a dilemma: it must balance its interests in economic cooperation with China against its interests in defending maritime territorial claims against China. Hanoi will need Beijing for its continued economic growth and stability because of the economic dependence it has with its northern neighbor. China is Vietnam's number one trading partner, estimated at \$50 billion in 2013.¹¹²

¹¹² Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock, An Update*, 21.

III. VIETNAM'S RESPONSE TO CHINA'S INCREASING THREAT

“The single most important feature in the realm of Vietnam’s foreign policy in the last five years is the rise of the South China Sea dispute to the top of the country’s national security and foreign policy concerns.”
—Alexander L. Vuving

The Sino–Vietnamese relationship has wavered throughout its two thousand year history. China once ruled Vietnam for a millennium before Vietnam gained its independence. China was a key supporter during the First Indochina War when North Vietnam fought the French for its independence. The two countries also fought a major war in 1979 when Chinese forces invaded northern Vietnam in retaliation for Vietnam’s invasion of Cambodia. Now, the two countries have restored diplomatic ties, and Vietnam’s economy has blossomed because of it. As Vietnam’s economy has grown, so has its dependence on the Chinese market for its growth and stability. This economic dependency has also influenced Vietnam’s foreign policy with China and how Vietnam will likely respond to China’s increasing threat to its sovereignty in the South China Sea.

There are several strategies and options Vietnam can use in response to the increased threat from China: bandwagoning, balancing, engaging, or hedging.¹¹³ Though these strategies are not all inclusive, this thesis will focus on Vietnam’s hedging strategy against China. It is an approach Hanoi is using that does not directly threaten Beijing or affect its economic relationship with its northern neighbor. As mentioned previously, Vietnam will likely not bandwagon with China because of the long history it shares with Beijing as well as its resentment towards the Chinese amongst the political elite. Additionally, Vietnam learned its lessons from its over-dependency on the Soviet Union in the 1970s and 1980s. When the Cold War ended and the Soviet Union collapsed, Vietnam lost its main financial and military supporter.

¹¹³ Vuving, “Strategy and Evolution of Vietnam’s China Policy,” 806.

A. INTERNATIONAL RELATIONSHIP STRATEGY

Hiep Hong Le defines bandwagoning as:

The smaller state's political and/or military alignment with the greater power to avoid being attacked, or a desire to be 'on the winning side' to reap economic gains from its relationship with the stronger power.¹¹⁴

In terms of balancing, the weaker state can modernize its military and increase defense spending to deter the stronger state from aggressively pursuing the weaker state.¹¹⁵ Additionally, balancing can be broken down further: hard, soft, internal, or external. An example of hard balancing can be represented by a state's modernization of its military. Soft balancing involves a weaker state deepening its ties with other foreign powers to counter undue pressure from the hegemon. Internal balancing is what a weaker state does domestically to strengthen its position: increase defense spending. External balancing is when a weaker state forges alliances with other countries to counter the hegemon; it is similar to soft balancing.

Hanoi considers a stable and peaceful relationship with Beijing as one of its top foreign policies.¹¹⁶ In addition to a stable and peaceful relationship, Hanoi knows there are other important factors to its relationship to Beijing. First, the two countries share the same ideology. At the end of the Cold War, Vietnam and China were under tremendous pressure to reestablish ties as the Soviet Union and the Eastern Bloc countries collapsed.¹¹⁷ The two ruling parties, the VCP and the Chinese Communist Party (CCP) believe "that a degree of mutual support helps to maintain their rule."¹¹⁸ Second, as mentioned in Chapter II, their economic interdependence is growing. Since 2004, China has been Vietnam's number one trading partner, estimated at \$50 billion in trade in 2013.¹¹⁹ Though Vietnam's trade deficit with China is estimated at \$20 billion in 2013,

¹¹⁴ Le, "Vietnam's Hedging Strategy," 336.

¹¹⁵ Ibid., 335.

¹¹⁶ Le, "Vietnam's Strategic Trajectory," 6.

¹¹⁷ Ibid.

¹¹⁸ Ibid.

¹¹⁹ Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 21.

Hanoi generally considers the bilateral economic relationship with Beijing beneficial and conducive to peace and cooperation.¹²⁰ Lastly, Vietnam's sovereignty concerns in the South China Sea have hampered the progress of the interrelationship between the two countries. The recent oil rig crisis near the Paracel Islands has renewed tensions that threaten the peaceful relationship between the two countries. Vietnam cannot afford a hostile relationship with its northern neighbor and wants to formulate a strategy that will likely bring stability into the region. Vietnam's hedging strategy is the best solution to Vietnam's sovereignty concern in the South China Sea that does not directly affect its economic relationship with China.

1. BALANCING

Le's hedging strategy is described as a "multi-tiered, omni-directional hedging strategy" in which states will use economic pragmatism, direct engagement, hard balancing, and soft balancing against a hegemonic power.¹²¹ In addition to Le's hard and soft balance, there is also external and internal balancing. External balancing involves "building alliances with third parties on the international stage" and internal balancing is "where a country builds up its domestic strengths to enhance its preparedness."¹²² Vietnam does not want China to be fearful of a strong U.S.–Vietnamese relation so the VCP attempted to strengthen its relations with Japan, India, South Korea, and Australia.¹²³ Additionally, Vietnam continues to open its seaports to encourage and expand its relationship with the international community.

The VCP has internally balanced against China by attempting to close the gap between the two countries' military capabilities by modernizing its military. Vietnam's navy has or is in the process of acquiring Svetlyak-class fast attack crafts, Gephard-class frigates, and six Kilo-class submarines. Additionally, it is upgrading its land-based

¹²⁰ Thu Le Huong, *Vietnam: Straddling Southeast Asia's Divide*, 2014; Le, "Vietnam's Strategic Trajectory."

¹²¹ Le, "Vietnam's Hedging Strategy against China," 335.

¹²² Huong, *Vietnam: Straddling Southeast Asia's Divide*.

¹²³ Le, "Vietnam's Strategic Trajectory," 11.

defense by acquiring Bastion anti-ship cruise missiles and extended-range artillery munitions. Vietnam has also developed its own defense industry through co-production and technology transfers. In cooperation with the Netherlands, it is building its own Sigma-class corvettes as well as patrol boats modeled on the Svetlyak offshore patrol vessel.¹²⁴ Additionally, the United States recently announced it has partially lifted its ban on arms sale to Vietnam to “support Vietnam’s efforts to improve its maritime domain awareness and maritime security capabilities.”¹²⁵ The lack in maritime capacity in the region may have influenced Washington’s decision to partially lift the arms ban. The lack in maritime capacity has become more apparent in the past couple of years as conflicts increased in the region.¹²⁶ Finally, India recently announced it has signed a defense and oil deal with Vietnam that will give the Vietnamese government an “expedited sale of four offshore patrol ships” as well as enhanced training programs for the Vietnamese military.¹²⁷

Vietnam’s strategy of hard-balancing is similar to its internal balancing of modernizing its military. It has increased its military spending the past decade and it appears the trend will continue to grow. Figure 4 shows Vietnam’s estimated military expenditure from 2003 to 2013 in U.S. dollars (using U.S. currency in 2011 as the constant).

¹²⁴ Le, “Vietnam’s Strategic Trajectory,” 10.

¹²⁵ Carl A. Thayer, “The U.S. Lifts Arms Embargo: The Ball Is in Vietnam’s Court,” *Diplomat*, October 6, 2014, <http://thediplomat.com/2014/10/the-us-lifts-arms-embargo-the-ball-is-in-vietnams-court/>.

¹²⁶ *Ibid.*

¹²⁷ Rishi Iyengar, “Risking China’s Ire, India Signs Defense and Oil Deals with Vietnam,” *Time*, October 29, 2014, <http://time.com/3545383/risking-chinas-ire-india-signs-defense-and-oil-deals-with-vietnam/>

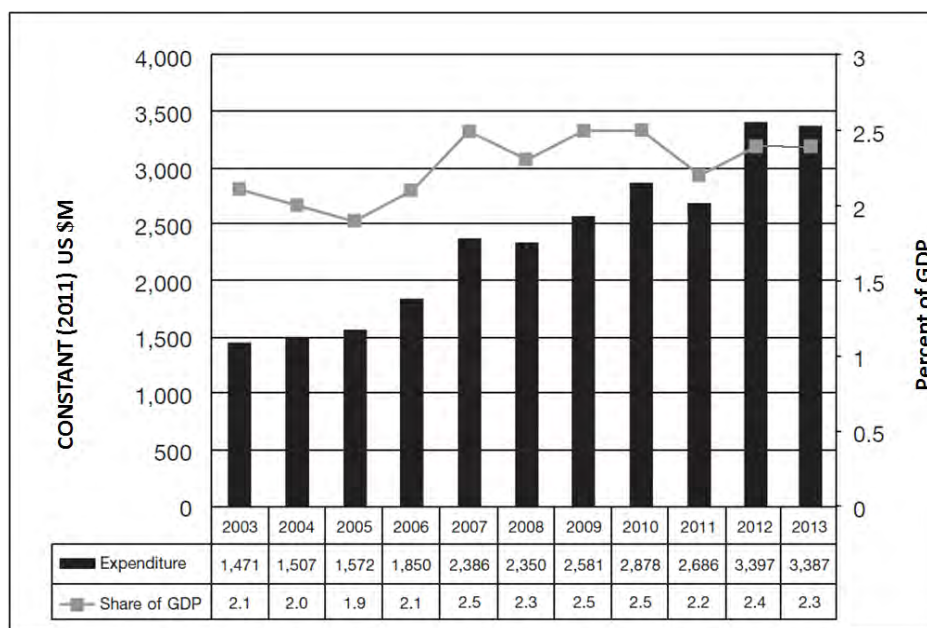


Figure 4. Vietnam's Estimated Military Expenditure (2003–2013)¹²⁸

The data from Figure 4 shows a trend that Vietnam will likely increase its military spending to counter China's continuing threat. Additionally, now that Washington has partially lifted its arms embargo with Hanoi, this may give Vietnam another reason to further increase its military spending in the foreseeable future. According to Carl A. Thayer, a Vietnam expert, Hanoi has shown an interest in developing anti-submarine warfare capability and to acquire the Lockheed Martin P-3 Orion with advance sonar equipment. The P-3 Orion will primary be use to protect its coastlines and EEZ against Chinese submarines.¹²⁹ Hanoi's actions have mainly been defensive in nature and should not be perceived by the Chinese as being aggressive. Vietnam uses these engagements to balance against China's threat and hopes to bring stability to the region while trying not to provoke its northern neighbor. These approaches are part of Le's hedging strategy Vietnam is using to strengthen its ability to defend its national interests while lessening the impact on its economic relations with China. Additionally, Vietnam's hedging

¹²⁸ Stockholm International Peace Research Institute (SIPRI), accessed October 8, 2014, http://www.sipri.org/research/armaments/milex/milex_database.

¹²⁹ Thayer, "The U.S. Lifts Arms Embargo."

strategy gives legitimacy to the VCP—Vietnam is better equipped to defend itself against China while limiting the impact to its economic relationship with its northern neighbor.

Some international relations experts argue Vietnam has shifted away from accommodation to one of defiance when dealing with China and its hegemonic rise in the region. Hiep Hong Le argues Vietnam has always feared China due to its proximity and power asymmetry, and “a far more powerful China has been the most serious source of threat for Vietnam throughout its history.”¹³⁰ Vietnam will not sacrifice “national sovereignty and territorial integrity in exchange for a ‘good’ relationship on Beijing’s terms.”¹³¹ That is one reason Vietnam has reached out to the international community for support to deter China’s aggression in the South China Sea as well as hedged against China’s dominance in the region.¹³²

Today, Vietnam finds itself in a precarious position of accommodation as well as defiance against a mightier China. Vietnam has increased its engagement with the United States and other nations in an attempt to deter future Chinese aggression. On the other hand, Hanoi does not want to lose its economic relationship with Beijing—its largest trading partner estimated at \$50 billion in 2013.¹³³ The oil rig incident last year tested the VCP’s resolve and placed great pressure on the Vietnamese government to respond more aggressively. China’s forceful approach in the disputed waters may have been a result of President Obama’s visit to the region a month prior. Beijing is likely concerned with the United States’ military rebalance to the Pacific and China wanted to show the world that it was free to do as it wishes in the South China Sea without fear of retaliation. China flexed its muscles against the smaller countries of Southeast Asia to demonstrate its ability to move about the South China Sea uncontested. Vietnam responded to China’s incursion by using diplomacy and without using or threatening the use military force. In addition to diplomacy, Vietnam used high-level talks to settle the oil rig dispute. Hanoi

¹³⁰ Le, “Vietnam’s Strategic Trajectory,” 6.

¹³¹ *Ibid.*, 7.

¹³² *Ibid.*

¹³³ “Learn More about Trade in Vietnam,” Observatory of Economic Complexity, accessed June 13, 2014, <http://atlas.media.mit.edu/profile/country/vnm/>.

also used the international community to place pressure on the Chinese to remove the oil rig. China will continue to threaten Vietnam's sovereignty in the South China Sea, and Vietnam will likely continue to respond diplomatically with high-level talks. Vietnam will likely use force as a last resort to defend its sovereignty if China attacks Vietnamese-held islands in the South China Sea.

Hanoi must be leery of both Beijing's influence and Washington's support as the Vietnam–China and Vietnam–U.S. histories have shown a mutual distrust between the countries have resulted in skirmishes and wars. Mainly, Hanoi fears Beijing's growing dominance in the region, both economically and militarily, and Hanoi may be forced to give up more of its claims in the South China Sea. On the other hand, Hanoi must walk a fine line between balancing against Beijing while trying not to anger it by partnering with the United States as a hedge against China's growing influence and power.

As disputes continue in the South China Sea, Vietnam will likely emphasize its balancing strategies against China. On the other hand, if the disputes are managed peacefully, a less threatening China will encourage Vietnam to lean towards bandwagoning.¹³⁴ Either way, Beijing asserts considerable influences on Hanoi and no major decision is made by the VCP without taking Beijing's possible responses into account.¹³⁵ In the meantime, Hanoi will continue to use diplomacy and find alternative solutions to deter future aggression. Some of the alternate solutions for the VCP includes modernizing its military, establishing or reaffirming third party relationships during times of peace and asking for their support during disputes and crises, opening its seaport to host ships of all nations, upgrading Cam Ranh Bay repair facility to support most modern ships as well as preparing it for its new fleet of submarines, increasing its engagements with other nations, and increasing its bilateral agreements and trade with its strategic partners.

¹³⁴ Le, "Vietnam's Hedging Strategy," 341.

¹³⁵ Thayer, "The Tyranny of Geography," 5.

Vietnam is also expanding the Cam Ranh Bay seaport to support ships of all nations.¹³⁶ The VCP is increasing the capacity of the seaport as it increases its engagement with its strategic partners and supporters. Additionally, Russia is assisting the Vietnamese government with building a submarine base in Cam Ranh Bay for Vietnam's Kilo-class submarines that the Vietnamese government is acquiring from Russia.¹³⁷ Furthermore, Cam Ranh Bay will become a repair facility to provide maintenance support for other naval platforms.¹³⁸ According to Vuving, Cam Ranh Bay is considered the "most coveted strategic harbor on the South China Sea."¹³⁹

In 2003, the VCP Central Committee redefined its "ideological approach to interstate relations with all countries by adopting the concepts of *doi tac* (object of cooperation) and *doi tuong* (object of struggle)."¹⁴⁰ Vietnam views these two concepts as a cooperation and struggle when its national interests are affected, specifically in terms of its relationship with China and the United States.¹⁴¹ Thayer argues that these two concepts explain why Vietnam consistently tries to stand up against a much stronger China over maritime disputes in the South China Sea while at the same time attempting to pursue a diplomatic strategy of emphasizing convergent interests.¹⁴² Vietnam continues to struggle to find a balance between confronting China when its sovereignty is attacked while attempting not to do anything to harm its economic relationship it shares with Beijing.

¹³⁶ Le, "Vietnam's Strategic Trajectory," 11.

¹³⁷ Stephen Blank, "Russia's Growing Ties with Vietnam," *Diplomat*, September 19, 2013, <http://thediplomat.com/2013/09/russias-growing-ties-with-vietnam/>.

¹³⁸ Blank, "Russia's Growing Ties with Vietnam."

¹³⁹ Vuving, "Vietnam in 2012: A Rent-Seeking State," 340.

¹⁴⁰ Thayer, "The Tyranny of Geography," 351.

¹⁴¹ Ibid.

¹⁴² Ibid., 351–352.

2. BANDWAGONING

Vietnam will likely not bandwagon with China as mentioned earlier in the chapter. As Vietnam continues to modernize its military and increase its engagements with the international community, it is also leery of trying not to provoke the Chinese. The majority of the VCP, led by Party Chief Nguyen Phu Trong, wants to accommodate China due to being fearful of getting closer to the U.S. because it may result in adverse pressures or even sanctions by the Chinese.¹⁴³ China poses more of a security threat to Hanoi than any other country, to include the United States. The Sino–Vietnamese relationship goes back two millennia and the distrust between the two countries continues today. The threat of armed conflict on land has decreased significantly since the two countries signed the bilateral land border treaty in 1999.¹⁴⁴ Vietnam’s main threat from Chinese aggression comes from the South China Sea. According to Zachary Abuza, a leading specialist in Southeast Asian security issues, it will be difficult for Vietnam to defeat a more powerful Chinese military and Vietnam will likely lose any war at sea against its northern neighbor.¹⁴⁵

Another possible reason China moved the oil rig into disputed waters may be to punish Vietnam’s continued close engagements with the United States. China may be fearful of a close US-Vietnamese relationship. A month prior to the oil rig incident, the Vietnamese and U.S. navies participated in a joint exercise that involved two U.S. Navy ships—the *USS John S. McCain* and the *USNS Safeguard*. According to the U.S. Embassy in Hanoi, the naval exercise focused on non-combatant professional exchanges in military medicine, search and rescue, diving and salvage, and shipboard damage control. The U.S. Embassy continued by stating it was “an opportunity to develop

¹⁴³ Teddy Pham, “A US-Vietnam Alliance? Not So Fast,” *Diplomat*, August 4, 2014, <http://thediplomat.com/2014/08/a-us-vietnam-alliance-not-so-fast/>.

¹⁴⁴ Le, “Vietnam’s Hedging Strategy against China,” 351.

¹⁴⁵ Abuza, “Vietnam Buckles Under Chinese Pressure.”

relationships that will serve both navies for many years to come through ship tours, 7th Fleet band concerts, sporting events, and community service projects.”¹⁴⁶

Though Vietnam continues to engage the United States with joint military exercises, Vietnam will attempt not to anger its northern neighbor by permitting a permanent U.S. naval presence in its ports or to establish an American military base in the country. Of all the options Vietnam has concerning its relationship with China and the United States, it will likely choose to have a closer relationship with China versus the United States for the following reasons: 1) Vietnam and China are only a handful of countries left in the world that have a communist government, 2) the economic relationship the two countries share is critical to Vietnam’s stability and growth, 3) the two countries’ close proximity and shared relationship has lasted two millennia, and 4) the recent incident with the oil rig *Haiyang Shiyu 981* demonstrated Vietnam’s inability to counter China’s threat and the lack of U.S. response to China’s incursion.

3. HEDGING

Some scholars believe Vietnam will balance against China while others believe it will bandwagon with China. Balancing and bandwagoning have been criticized as being too narrow and there are other strategies Vietnam can use against China. Hiep Hong Le argues the best option for Vietnam is to hedge against China, using a “multi-tiered, omni-directional hedging strategy” in which states will use economic pragmatism, direct engagement, hard balancing, and soft balancing against a hegemonic power.¹⁴⁷ Carl A. Thayer, a Vietnam expert, agrees with Le’s hedging strategy using similar arguments that state Vietnam will likely use high-level party and state visits as a diplomatic tool to codify its relations with China, promote multilateral institutions, and develop its own sufficient military capacity to deter China from using force.¹⁴⁸

¹⁴⁶ “The U.S. and Vietnamese Navies Build Confidence during NEA 2014,” Embassy of the United States, last modified April 7, 2014, <http://vietnam.usembassy.gov/mobile/highlight-040714.html#>.

¹⁴⁷ Le, “Vietnam’s Hedging Strategy against China,” 335.

¹⁴⁸ Thayer, “The Tyranny of Geography.”

Hanoi's hedging strategy goes beyond the balance of power approach. With the purchase of military equipment from Russia, Vietnam is now better equipped to defend its sovereignty. It was reported that Vietnam reached an agreement with Russia to buy the Kilo-class submarines for approximately \$1.8 billion.¹⁴⁹ The deal took place as Hanoi sustained severe trade deficits during the global financial crisis. Vietnam has already acquired Tarantul missile corvettes and frigates, as well as Su-27 jet fighters from Russia. Vietnam has also been looking elsewhere to purchase military equipment to supplement its defense. Hanoi bought two submarines from North Korea in the 1990s and is looking at Serbia to purchase second-hand Kilo-class submarines as well.¹⁵⁰

During the six-day exercise, China closely monitored the exchanges between the U.S. and Vietnamese navies. China may be weary of the US-Vietnam growing relationship. With the United States' military rebalance to Asia, this exercise was a demonstration of the US's commitment to its allies and partners in the region. Hanoi is attempting to form a closer relationship with Washington in attempt to hedge against Beijing, especially with recent events in the region. The U.S.-Vietnam relationship is very important for the Vietnamese government to help secure and restrain China from further aggression. The U.S.-Vietnam relationship has grown steadily through the years and appears to be expanding to other aspects of mutual support to include humanitarian assistance and disaster relief, accounting and recovery of U.S. service members missing since the Vietnam War, and non-governmental agencies support and participation.¹⁵¹

Vietnam will likely continue to favor a diplomatic solution versus military action to resolve conflicts with China. Vietnam's foreign policy will be to hedge against China, thus any future conflicts may be lessened if China does not see Vietnam as a threat. Vietnam will continue to press China for a stronger bi-lateral relationship and encourage open dialogue concerning any conflicts between the two countries. On the other hand, China may be fearful of a strong Vietnam-US relationship and will not cross the line to

¹⁴⁹ Cheng, "Sino-Vietnamese Relations," 379-405.

¹⁵⁰ Ibid.

¹⁵¹ "U.S. Relations with Vietnam," U.S. Department of State, last modified February 14, 2014, <http://www.state.gov/r/pa/ei/bgn/4130.htm>.

make Vietnam feel cornered. This may be a possible reason China removed the oil rig *Haiyang Shiyu 981* a month earlier than planned. On July 15, 2014, the Vietnamese coast guard confirmed the oil rig was removed from the disputed waters near the Paracel Islands and was towed to Chinese waters.¹⁵²

4. ENGAGING

According to Le, “Vietnam has made efforts to promote economic cooperation with China and directly engage it in various bilateral arrangements to boost mutual trust and cooperation.”¹⁵³ The VCP understands the importance of its economic relationship with China and wants to foster a policy that favors this relationship. Even with a \$20 billion trade deficit, Vietnam continues to look to China for its economic growth and stability.¹⁵⁴ In 2009, Vietnam held approximately 300 meetings with its Chinese counterpart to discuss bilateral trade.¹⁵⁵ These meetings reflect Hanoi’s direct engagement with Beijing to promote trade as well as to settle disputes and encourage peaceful resolutions without affecting the economic relationship.

The Vietnamese government aggressively pursued all avenues of diplomatic pressures to resolve the oil rig incident that began in May 2014. The Vietnamese people on the other hand took to the streets to demonstrate their anger with the Chinese government. These demonstrations turned violent and deadly as Chinese-owned businesses, as well as other foreign-owned businesses, were targeted and set ablaze. Some reports put the death toll at 21 with hundreds injured as the Vietnamese rioted throughout the industrialized sectors of Vietnam.¹⁵⁶ The Vietnamese government was troubled because it appeared the VCP initially permitted these demonstrations to occur

¹⁵² David Stout, “China Removes Contentious Oil Rig from Waters Claimed by Vietnam,” *Time*, July 25, 2014, <http://time.com/2990590/oil-rig-leaves-contested-waters-vietnam-china/>.

¹⁵³ Le, “Vietnam’s Hedging Strategy against China,” 335.

¹⁵⁴ Huong, *Vietnam: Straddling Southeast Asia’s Divide*.

¹⁵⁵ *Ibid.*

¹⁵⁶ “Up to 21 Dead, Doctors Says, as Anti-China Riots Spread in Vietnam,” Reuters, July 15, 2014, <http://www.reuters.com/article/2014/05/15/us-vietnam-china-riots-casualties-idUSBREA4E03Y20140515>.

without doing much to stop it.¹⁵⁷ As the demonstrations turned violent, the Vietnamese government stepped up its police presence and arrested hundreds of protesters. Thousands of Chinese factory workers fled the country, some across the border into nearby Cambodia.¹⁵⁸ Chinese airlines operating in Vietnam added additional flights out of the country to aid in the evacuation and the Chinese government dispatched several ships to assist with the evacuation of its citizens.¹⁵⁹

Vietnam has also sought third party involvement in pursuit to the Chinese threat by establishing strategic partners that may help deter Chinese aggression. In July 2013, Vietnam and Russia formally elevated their 11-year old strategic partnership to a “comprehensive strategic partnership.”¹⁶⁰ The Russian-Vietnamese comprehensive strategic partnership is now equal to the Sino-Vietnamese comprehensive cooperative strategic partnership, and higher than Vietnam’s other strategic partnerships.¹⁶¹ Russia is also assisting the Vietnamese government by selling military equipment and weapons to modernize Vietnam’s military. The establishment of bilateral partnerships with other countries is very important to the Vietnamese government as they may help stabilize and maintain peace in the region.

Vietnam has increased its engagement with the United States and other countries to act as a counterbalance to the continuing Chinese aggression in the South China Sea. Vietnam’s hedging strategy can be viewed as defensive in nature and Hanoi’s strategy will better help maintain its close relationship with Beijing. The outreach to increase engagements with other nations in Vietnamese waters has showed the VCP’s resolve to

¹⁵⁷ Zach Beauchamp, “There are Anti-Chinese Riots in Vietnam. This Should Really Worry China,” Vox, last modified May 16, 2014, <http://www.vox.com/2014/5/16/5720988/vietnam-riots-china-strategy>.

¹⁵⁸ “Up to 21 Dead, Doctors Says, as Anti-China Riots Spread in Vietnam.”

¹⁵⁹ Jason Folkmanis, Uyen Nguyen, John Bourdreau, and Yu-Huay Sun, “Anti-China Riots in Vietnam Kill 2 as Workers Flee,” Bloomberg Business, May 15, 2014, <http://www.bloomberg.com/news/articles/2014-05-14/anti-china-protests-in-vietnam-spur-warnings-factory-closures>.

¹⁶⁰ Vuving, “Vietnam in 2012: A Rent-Seeking State,” 337.

¹⁶¹ Ibid., 337–338.

find alternative strategies to counter the Chinese problem without directly provoking Beijing.

Le continues to describe Vietnam's approach toward China's threat as a "calibrated mixture of deference and defiance."¹⁶² Vietnam wants to peacefully resolve disputes with China as quickly as possible while trying not to antagonize its northern neighbor. The VCP will likely continue to use diplomacy as well as find other multi-lateral solutions to deter future Chinese aggression while trying not submitting to China's growing threat.

The Vietnamese government will likely continue to debate over its response to China's continuing threat. The key to its response will likely be the economic relationship Hanoi has with Beijing; the VCP will likely formulate a strategy that limits the impact on its economy as well as the economic relationship with Beijing. Vietnam's leadership will continue to respond diplomatically with high-level talks. In the meantime, the VCP's strategy is to hedge against its northern neighbor by increasing its defense spending by modernizing its military, opening its seaport to the international community, continuing to participate with the U.S. and the international community through increased military exercises, and directly engaging with China to settle future disputes in the South China Sea. Vietnam believes its actions are defensive in nature and peace and stability in the region will continue.

The oil rig incident in the South China Sea appears to be history repeating itself. In 2014, Hanoi marked the 40th Anniversary of Chinese invasion of the Paracel Islands that killed 70 Vietnamese soldiers. Beijing has controlled the island chains ever since that invasion. China's aggressive maneuver near the Paracel Islands may be an initial push to control the rest of its claims in the South China Sea. China may be testing Vietnam's response, as well as the responses from other countries in order to calculate the risks of adding additional oil rigs to other parts of South China Sea, possibly near the Spratly Islands. The Spratly Islands in the South China Sea are disputed by six countries in the region, to include Vietnam and China. If Vietnam does not respond accordingly to the oil

¹⁶² Le, "Vietnam's Hedging Strategy," 334.

rig incident near the Paracel Islands, China may continue to exert its power to push for control of the rest of the South China Sea.

B. CONCLUSION

Vietnam's foreign policy and response must be strong but calculated. It must calculate the risk of antagonizing its biggest trading partner with defending its sovereignty. The latest incident concerning the oil rig is a security concern for Hanoi and the incursion will put pressure on the Vietnamese government to respond more aggressively to future aggression by the Chinese. Vietnam will not likely escalate the situation further by using military force—there is too much at stake for both countries to pursue military action because of the economic relationship the two countries share. Furthermore, Vietnam will not likely use military force to stop China's aggression because of the asymmetric military capabilities of China over Vietnam's smaller military force. If the two countries should go to war over territorial disputes in the South China Sea, Vietnam will probably not be able to defend its sovereignty and will likely be defeated.

The disputes in the South China Sea will continue and will likely not end any time soon; the importance of the region is too great for the two countries to let go. The surrounding waters adjacent to the Paracel Islands, as well as the rest of the South China Sea are rich in natural resources and the potential oil and gas reserve under the seabed is tremendous. According to the U.S. Energy Information Administration (EIA), the South China Sea is critical to the world trade route and has a potential source of hydrocarbons, particularly natural gas. The EIA estimates the South China Sea contains approximately 11 billion barrels of oil and 190 trillion cubic feet of natural gas in proved and probable reserves.¹⁶³ Hanoi wants to expand offshore production in the South China Sea as a way to meet the domestic demand as well as contributing to state finances. Besides the natural resources off Vietnam's coast, Vietnam is concerned with the encroachment of China in what it sees as a violation to its sovereignty. As countries continue to grow and the

¹⁶³ "South China Sea: Analysis Brief," U.S. Energy Information Administration, last modified February 7, 2013, <http://www.eia.gov/countries/regions-topics.cfm?fips=scs>.

demand for fuel increases, the South China Sea continues to be an important region for the potential gas and hydrocarbon reserves to meet the demands for the countries that border the region.

IV. CONCLUSION

Vietnam's economic relationship and dependency to China is one of the main driving forces behind its foreign policy with its northern neighbor. Vietnam's security concerns and sovereignty issues in the South China Sea appears to be secondary only to Vietnam's economic growth and stability. Vietnam has grown increasingly leery of China the past few years as China increased its aggression in the South China Sea. Vietnam does not want to provoke its northern neighbor but does not want to appear weak when responding to China's aggression. The VCP's best strategy against Chinese aggression is to hedge against Beijing by using a "multi-tiered, omni-directional hedging strategy" in which the VCP will use economic pragmatism, direct engagement, hard balancing, and soft balancing against a stronger China.¹⁶⁴ This strategy does not directly threaten Beijing and should make little impact to the economic relationship between the two countries.

The Vietnamese economy was decimated in the 1970s and 1980s after North Vietnam struggled to merge North and South Vietnam into one country. In 1985, the World Bank ranked Vietnam as one of the top five poorest countries in the world with a gross domestic product (GDP) per capita of about \$130 per year.¹⁶⁵ The following year, the Sixth National Congress of the VCP adopted *Doi Moi* (Renovation), a policy with the goal of a socialist-oriented market economy to lift the country out of poverty. As a result of *Doi Moi* and its economic liberalization, Vietnam's economy began to grow and its poverty rate slowly declined.¹⁶⁶ Since the mid-1990s, China has become Vietnam's number one trading partner, estimated at \$50 billion in 2013.¹⁶⁷ Vietnam has now become more dependent on the Chinese market for its economic growth and stability. As its economy grows more dependent on China, so has the cost of challenging Beijing and

¹⁶⁴ Le, "Vietnam's Hedging Strategy against China," 335.

¹⁶⁵ Glewwe, "An Overview of Economic Growth and Household," 1.

¹⁶⁶ "Data: Vietnam," The World Bank, accessed February 1, 2015, http://data.worldbank.org/country/vietnam#cp_fin.

¹⁶⁷ Dinh, Demombynes, and Badiani-Magnusson, *Taking Stock: An Update*, 21.

it has made it very difficult for Hanoi to challenge its northern neighbor when its sovereignty is threatened. The Vietnamese government faces a dilemma: it must balance its interests in economic cooperation with China against its interests in defending maritime territorial claims against China. This thesis concludes Vietnam will favor its economic growth and stability over its sovereignty concerns.

Vietnam's security and sovereignty concerns are still a priority to the VCP as they attempt to maintain peace and stability in the region. Vietnam has reached out to the international community to help quell crises in the South China Sea. The Vietnamese leadership continues to respond diplomatically with high-level talks with the Chinese government to resolve all issues concerning the South China Sea disputes. In the meantime, the VCP's strategy is to hedge against its northern neighbor by increasing its defense spending, modernizing its military, opening its seaport to the international community, continuing to participate with the United States and the international community through increased military exercises, and by directly engaging with the Chinese to settle disputes in the South China Sea.

Vietnam's hedging strategy should be viewed as defensive in nature and should not be viewed as a threat to the Chinese government; thus, the impact to Hanoi's trade with Beijing should be limited. Disputes and sovereignty concerns in the South China Sea continue as some of the Southeast Asian countries, as well as China, vie for control of their claims in the region. There is no one size-fit-all solution to the problem. The only immediate solution appears to be that all states involved in the South China Sea dispute should respect one another's claims and to not take any actions that threaten another country. They should continue to handle all crises with diplomacy and the use of force or the threat of use of force should not be considered as tension in the region continues to be at an all-time high. All states should respect each other's claims and continue to work out differences for the betterment of peace and stability in the region.

Vietnam's trade and economic dependency with China are the driving force behind its foreign policy with its northern neighbor. Vietnam needs the Chinese market for its continued economic growth and stability. In the meantime, Hanoi continues to hedge against Beijing and hopes that one day it would be able to pull away from China's

grip to become less dependent. Vietnam has made a tremendous turn-around in the last few decades to become a viable leader in the region with its commitment to keep the region safe and stable when conflicts erupt off its coasts. Vietnam's economy will likely continue to grow and the Sino–Vietnamese economic relationship is uncertain in the next decade. The only thing that is certain will be the South China Sea disputes.

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