Trade Follows the Flag or Business as Usual? Economic Impact of South China Sea Dispute in China-Philippines Relations from 2012 to 2016

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Abstract

Mainstream scholarship exploring the relationship between political conflict and bilateral trade have often been cast into a dichotomy between the realist and liberal schools of thought. This study investigates the trade-conflict nexus in the context of the South China Sea dispute between China and the Philippines from 2012 to 2016, with a special focus on changes in Filipino export to China after the Scarborough Shoal standoff in April 2012. To do so, this paper uses trade data from the China Customs Database and the Synthetic Difference-in-Differences (SDiD) estimator to quantitatively assess the negative treatment effect on Filipino export to China from 2012 to 2016. Contrary to previous papers on the topic, our result shows that no significant negative treatment effect was found in both the immediate aftermath of the conflict and the long run. This supports the predictions of liberal IR scholars that territorial dispute does not exert a significant disruptive effect on bilateral trade even as the conflict persists.

1 Introduction

On the 8th of April 2012, an intense standoff occurred between China and the Philippines when a Filipino Naval ship tried to arrest Chinese fishermen entering the Scarborough Shoal, a group of shoals and rocks claimed by both countries (Castro, 2016). As the confrontation continued, both sides took measures to raise the bar of the game by deploying more maritime surveillance and naval ships to the region. While the standoff ended in June 2012 when the United Stated facilitated a negotiation between the two countries, tensions have continued between the two countries, with confrontations occasionally erupting from 2012 to 2016 (CSIS, 22 May 2017).

How profound are the negative economic externalities produced by severe political conflicts between states? Scholars from the two major schools of International Relations (IR) theory disagree on this crucial question. The realists believe that political conflicts produce significant and persistent negative economic externalities, especially in those cases where the territorial integrity of a country is at stake (Waltz, 1979; Mearsheimer, 2007). According to the realists, "severe political tensions motivate states to reduce economic interdependence and discourage private actors from having further economic exchanges" (Gowa & Mansfield, 1993). This is particularly so in the context of an increasingly nationalistic and assertive China from 2009 onwards (Callahan, 2014). In contrast, liberal IR scholars believe that political tensions produce limited negative externalities on trade, as the potential gain from trade incentivises states to contain the spillover effect even if the dispute remains unresolved (Oneal & Russett, 1997; Ikenberry, 2011).

This paper joins the debate on the trade-conflict nexus by empirically examining how the recent round of the South China Sea (SCS) dispute, starting with the April 2012 Scarborough Shoal standoff, has disrupted bilateral trade between China and the Philippines with a specific focus on Filipino export to China. The results provide evidence in contrast with previous studies on the topic as our model found no evidence of a significant negative externalities produced by political conflict on trade. The paper makes three important contributions. First, this paper contributes to the IR theoretical debate on whether the political interests of states can override gains from economic cooperation. The paper argues that economic interests were a significant motivation for both China and the Philippines to mitigate political tension despite rising nationalism at home in the case of the China-Philippines territorial dispute of SCS islands. Second, the paper adopts the newly invented Synthetic Difference-in-Difference method (SDiD) method, which is methodologically and mathematically more accurate compared with commonly adopted methods such as the Difference-in-Difference method (DiD) and the Synthetic Control Method (SCM). This allows us to provide more accurate findings on whether political conflict can produce significant negative externalities while bilateral trade is at stake. Lastly, the paper demystifies China's foreign policy behaviours. As a rising geopolitical power that is often accused of seeking to revise the existing international order, China's foreign policy is often considered a black box where political calculation is at the centre of decision-making. However, the paper shows that economic factors are significant in China's foreign policymaking. This can help international actors find a more balanced and tactical strategy to engage with a rising great power.

The paper proceeds as follows: Section two explores the existing theories that explain the relationship between bilateral trade and international conflict, as well as the contemporary scholarship that focuses on the subject. Section three provides a detailed account of the recent history of China-Philippines relations and the evolution of the territorial dispute. Section four presents the research method and the

SDID model. Section five and six discusses the findings of our model and provides the interpretations of the results. And finally, section seven concludes the paper by summarising the findings and contributions of the paper.

2 Literature review

2.1 A Theoretical Debates Between the Liberal and the Realist IR Scholars

Bilateral political conflict, in its most straightforward from, refers to a "controversy, disagreement, quarrel or warfare between or among two or more nations or countries", where economic, political, and military means is often mobilised by one or both parties involved in the conflict. According to Davis and Meunier (2011) and Yan et al. (2010), the severity of bilateral political conflict can be categorised in "tense", "threatening" to "on the brick of war" and war. In the most simplified form, a "tense" political relation refers to a situation where two countries might get into a disagreement over a certain issue, where diplomatic protest is often made and high-level government officials in both countries issue statements on the matter. A "threatening" political conflict refers to a situation where the matter is not resolve and threats of concrete actions, such as military deployment and economic sanctions might be taken. A political conflict that is on the brick of war is observed where the dispute has escalated to the point that military deployments have been made, or small-scale confrontations have taken place, and the threat of war is imminent. Lastly, war refers to a situation where severe and direct military confrontation broken out.

Conflicts may lead to serious consequences in international trade and cooperation in various ways such as raising trade and production cost, increasing trade uncertainty and generating trade diversion. Currently, scholars across both disciplines concur that economic bilateral activities are sure to suffer when political relations deteriorate to the point of war and suffer little with low level conflict (Wang, 2015). However, in the contemporary era where international law and influential organisations like the United Nations have delegitimised war as a means to settle bilateral disputes, most political conflict do not escalate to the extreme outcome of war. Hence, the impact of severe political conflicts, such as those charaterised as "threatening" and "on the brick of war" on trade are widely debated issue in the study of both the discipline of international relations and international political economies.

From the perspective of classical realist scholars such as Hans Morgenthau, Kenneth Waltz and John Mearsheimer, there is no question that a severe political conflicts where political relations have deteriorated to the edge of war will exert a significant and persistent negative impact on bilateral economic activity (Morgenthau, 1948; Waltz, 1979; Mearsheimer, 2007). At the state level, the realists perceive the international order fundamentally as inter-state competition for power between states under an anarchic order; economic factors, such as trade, are merely instruments to advance national interests (Mearsheimer, 2007). Hence, when political conflict arises, states are incentivised to reduce trade with the adversary, fearing that the adversary's gains from trade will be "transformed into military use that places itself in a disadvantageous position" (Stein, 2003). Furthermore, in times of conflict, trade and investments are *weaponised* as means to serve the political goals of the respective states (Dixon & Moon, 1993; Bliss

& Russett, 1998; Morrow et al., 1998; Guiso et al., 2004). This explains why political conflicts are frequently associated with the imposition of trade embargoes which significantly affect bilateral trade (Glick & Taylor, 2010). Furthermore, the distinctiveness in China's internal economic structure makes the realist perspective especially relevant to our study. In particular, China's state-owned-enterprises (SOEs), commonly regarded as an extension of the state in the economic sphere, account for a considerable portion of its economy. Regarding foreign trade, nearly 50% of Chinese imports were made by Chinese SOEs (Li & Li, 2015). Hence, countries that engage in a political conflict with China might experience a more significant trade disruption as compared to engaging in conflicts with other countries, as the Chinese SOEs will implement the government's will with little hesitation.

Furthermore, governments and SOEs are not the only party involved and affected by political conflict. Realist scholars such as Pollins (1989) have thus extended the logic to other units of analysis and proposed the "trade follows the flag" theory to explain how political conflict disrupts bilateral trade at the business level even without explicit state sanction. According to Pollins (1989), rational private actors such as businesses and individuals consider not only the price and quality of goods but the origins of the products and the political relationship between these places and their countries. In short, private actors follow their respective governments' flag, "importers buy from friends, consumers punish foes" (Pollins 1989).

On the other hand, while contending with the realist that economic relations between states will be affected when states are engaged in serious conflicts, different groups of liberal IR scholars propose several different interpretations. One major school of liberal theorists, such as Copeland (2015), Gartzke (2015) and *Ikenberry (2018),* proposed the commercial peace theory to explain how interdependence and fear of loss from trade deter liberal states from getting into conflict in the first place. In contrast to realists who see economic relations as a *mean* to advance the national interest, they see bilateral economic relations as an essential *aspect* of national interest and assume that bilateral economic relation generates benefits for both parties. Coming from this assumption, they believe that the cost of trade disruption is very high, especially between countries with a high level of interdependence in their economic relations. Hence, based on rational calculation, economically interdependent liberal states should avoid becoming embroiled in political disputes to avoid disruptions of bilateral economic activities (Gartzke, 2015). Building from the commercial peace theory, Davis and Meunier (2011) propose in their "business as usual" model that even if severe political conflicts broke out inevitability between liberal states, it should cause only brief and minor trade disruptions. They suggest that countries logically try to keep economic dealings apart from political issues, so trade continues even during disagreements. This underscores the enduring economic bonds between liberal states and their commitment to trade, even in the face of political challenges.

Furthermore, in contrast to the classical realist, liberal IR scholars do not simply treat different actors within the country as a mere extension of the government's will but instead as actors capable of influencing the government's calculation in the decision-making process via lobbying. For liberal theorists, "sustained and increased economic exchanges among states incubate vested domestic interest groups that suffer from trade disruptions" (Ikenberry,*2018*). Therefore, businesses do not alter their trade relations when political tensions between two states arise but instead seek to lobby their respective governments to contain the spillover effect on the economy (Copeland, 1996; Jervis, 2002; Xing & Zhou, 2018). According to Davis and Meunier (2011), the incentive of business groups and individuals to lobby the government is further enlarged by the recent round of neoliberal globalisation, as the increasing integration of the global value chain means that businesses are likely to incur even more losses from trade

disruption. Hence, the rational calculation should prevent businesses from linking economic decisions to political relations and instead lobby against their respective governments (Davis & Meunier, 2011).

2.2 Previous Work Focused on China's Trade Relationship

China has in recent years experienced several political disputes with its neighbouring countries as well as major powers, and the degree to which bilateral trade is affect varies on the level of conflict. Numerous scholarly studies have examined the influence of these conflicts on trade using different methods. Scholars such as Du et al. (2017) have applied an event study model to analyse the impact of political conflict between China and nine of its important trading partners from 1990 to 2013. They found that while political conflicts have a severe negative impact on bilateral trade in the immediate aftermath, their impact is short-lived, usually only within the initial few months of conflict. The same conclusion was also reached by Whitten et al. (2020), who analysed China's trade relations with its twelve major trading partners from 2009 to 2019. However, one major limitation of this group of studies is that they do not differentiate between different types of political disputes. Instead, they assume a wide range of disputes to have equal treatment effects. In reality, different forms of political conflicts will result in different levels of responses taken by the two involved countries. A confrontation due to the territorial dispute is expected to exert a much more disruptive impact on bilateral political and economic relations than the political tension that arose after Dalai Lama's visit.

Another group of scholars pays specific attention to the impact sereve political conflict such as those classified as "on the brick of war", where military confrontation in imminent on bilateral trade (Davis & Meunier, 2011; Qaddos,2018; Gurung, 2018; Li & Liu, 2019). Davis and Meunier (2011) presented empirical evidence supporting the liberal thesis. Using quarterly bilateral trade data from 1990 to 2006, they showed that varying levels of political tensions in China–Japan relations had no adverse effects on these nations' trade and investment flows. In a rebuttal paper to Davis and Meunier, Li and Liu (2019) analysed the responsiveness of trade to territorial disputes from September 2010 to January 2014. They found a visible disruption to bilateral trade across different sectors. Their finding is further supported by Li et al.'s (2021) examination of the impact of the China-Japanese territorial dispute on bilateral trade in the same period. However, both papers do not present a good rebuttal against Davis and Meunier's findings as they differ in their analysis periods. While the Senkaku island conflict existed long before 2010, confrontations after 2010 were observably much more severe (Manicom, 2014) as a result of the rising nationalism in China. This is especially the case for the August 2012-Senkaku Island confrontation, as it led to an unprecedented nationwide anti-Japanese boycott and demonstrations lasting for two months across China (Manicom, 2014).

Research related to the impact of territorial conflict on bilateral trade between China and Southeast Asian (SEA) countries is relatively rare. One paper that closely resembles our topic is Wang (2015), which similarly assessed the impact of multiple conflict events among the South China Sea disputes on Sino-Filipino trade with an event-study design from 2009 to 2012. She has reached a conclusion similar to Du et al. (2017) and Whitten et al. (2020) that there was a severe negative impact on trade in the quarter after the bilateral conflict broke out, but the disruptive impact lasted only for one quarter. However, the accuracy of her finding is questionable due to serval errors in her model. Firstly, her econometric model controls for GDP and exchange rates, which introduce *post-treatment bias* to the effect estimates since both exchange rates and GDP were subject to the conflicts between the two countries given China's importance to the Philippines as a major trade partner (China is the largest trading partner

of the Philippines). Moreover, Wang (2015) did not include a control group for comparison, which is common in difference-in-differences event study designs. This means that any confounding events that affected all trade partners of China could have contaminated her estimates. In contrast, our synthetic difference-in-differences approach presents a superior design that accommodates these problems. Neither did Wang (2015) report which standard errors were used in her results.

Furthermore, while most existing research focused on conflicts that took place prior to 2012, several changes in China's domestic politics have made China's foreign policy increasingly nationalist and assertive since the late Hu Jingtao's presidency, which may invalidate the conclusion reached by Wang (2015) and Du et al. (2017). Firstly, there have been changes in China's top leadership's perception of its capability since the late Hu Jintao era. According to John (2008), China's eye-catching economic performance amidst the 2008 Global Financial Crisis (GFC) has convinced Chinese leaders that "China was on the rise while the West was on the decline" and that the "Chinese leaders could shape events in Asia as never before". In addition, the successful management of the GFC and the successful opening of the 2008 Beijing Olympics has also led to an accumulation of nationalism in Chinese society. The Chinese people have also become increasingly confident of China's national power and were more confident with using force to “punish anyone who dared to insult the motherland” (Johnston, 2017). In this context, the China-Philippines standoff in April 2012 and the China-Japan Senkaku island standoff later in June became the erupting point of nationalism and confidence accumulated within Chinese society (Barcu, 2021), it's argued that these events signal a more realist shift in Chinese foreign policy. This might have made negative implications on bilateral economic relations much more long-lasting as compared to the previous era, hence invalidating the findings of the previous research. Hence, drawing on the interaction of the two countries in the Scarborough Shoal Standoff, this research attempts to examine if the increasing assertiveness in China's foreign policy approach has made economic interests less important in the country's foreign agenda.

3 Overview of China-Philippines Relations from 1990 to 2016

3.1 China-Philippines Relations Since the 1990s

China-Philippines relations have experienced frequent fluctuations since the 1990s. From the 1990s to the early 2000s, the relationship between China and the Philippines was "harmonious". Maria Gloria Macapagal-Arroyo, the fourteenth president of the Philippines who served from 2000-2009, adopted a friendly gesture towards China with an emphasis on economic cooperation (Castro, 2012). The Philippines' trade with China grew faster than its trade with the rest of the world—with exports to China growing at an average of 17% annually from 1996 to 2008 (World Bank, 2010).

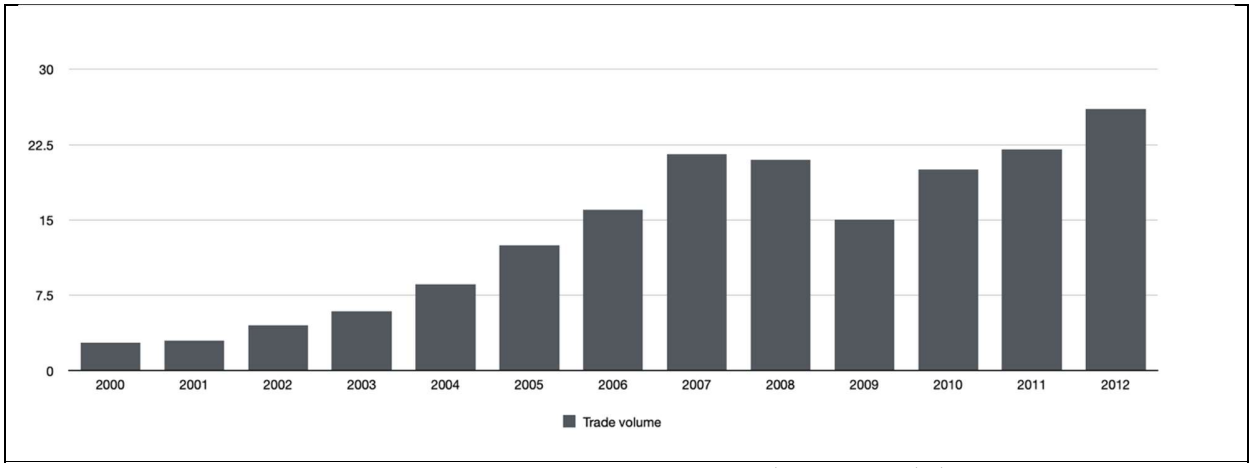


Figure 1: China-Philippines Trade Volume from 2000 to 2012 (Billion USD) (Source: The Observatory of Economic Complexity, 2013)

However, the situation changed dramatically from 2010 onwards due to domestic political changes in both countries. In conjunction with the rising nationalism in China, there was widespread anti-Arroyo and anti-China sentiment in the Philippines due to accusations that the Arroyo administration was "trading the Philippines' territorial sovereignty with China for personal economic benefits" (Ortuoste, 2013). Aquino III, who came to power by taking advantage of the anti-Arroyo sentiments during his presidential campaign, had consciously adopted an anti-China image. For example, in his speech during the 113th anniversary of the Filipino Department of Foreign Affairs in 2011, Aquino III criticised Arroyo's China policy and highlighted that he "will not trade Filipino sovereignty for economic benefits" (Calica, 2011). In addition, the increasing support from the US to the Philippines, as manifested in Barrack Obama's "Pivot to Asia" policy, had further boosted Aquino III's confidence to confront China (Ortuoste, 2013). Thus, the rising nationalism in China and the growing anti-China sentiments within Filipino society paved the way for the intensive and long-lasting conflict in 2012.

Confrontations and standoffs occurred a few times in 2009 and 2011 before the 2012 Scarborough Shoal standoff. For example, in early 2011, two incidents occurred as the Filipino oil exploration vessels reported that their operation within the Filipino Exclusive economic zone (EEZ) had been interfered with by Chinese civilian and maritime police ships. However, these incidents did not produce severe consequences due to the low-intensity nature of the confrontations (Wang, 2015). In July 2011, tensions in the SCS were eased when China and ASEAN member states agreed to adopt the Guidelines for implementing the Declaration on Conduct (DOC) (ASEAN Secretariat, 2011). Since then, both sides have backed down on their territorial claims, and no clashes have taken place until the Scarborough Shoal Standoff.

3.2 The Scarborough Shoal Stand-off and its Aftermath (2012-2016)

The 2012 Scarborough Shoal Standoff was the tipping point of China-Philippines relations that occurred amidst the rising nationalism in China and anti-Chinese sentiment in the Philippines. The Scarborough Shoal, a group of islands, rocks and shoals located near the Philippines, is believed to be rich in resources, such as fish, oil and gas (Castro, 2015). The standoff began on the 10th of April 2012, when the Philippine Naval ships tried to arrest eight Chinese fishing boats anchored inside the Scarborough Shoal. However, two Chinese maritime surveillance vessels arrived and prevented the arrest of the Chinese fishermen. This

marked the beginning of a standoff, as both sides increased their military presence in the area. The standoff eventually ended in June 2012, when both sides agreed to withdraw their vessels from the area and engaged in negotiations to resolve the dispute (Ortuoste, 2013).

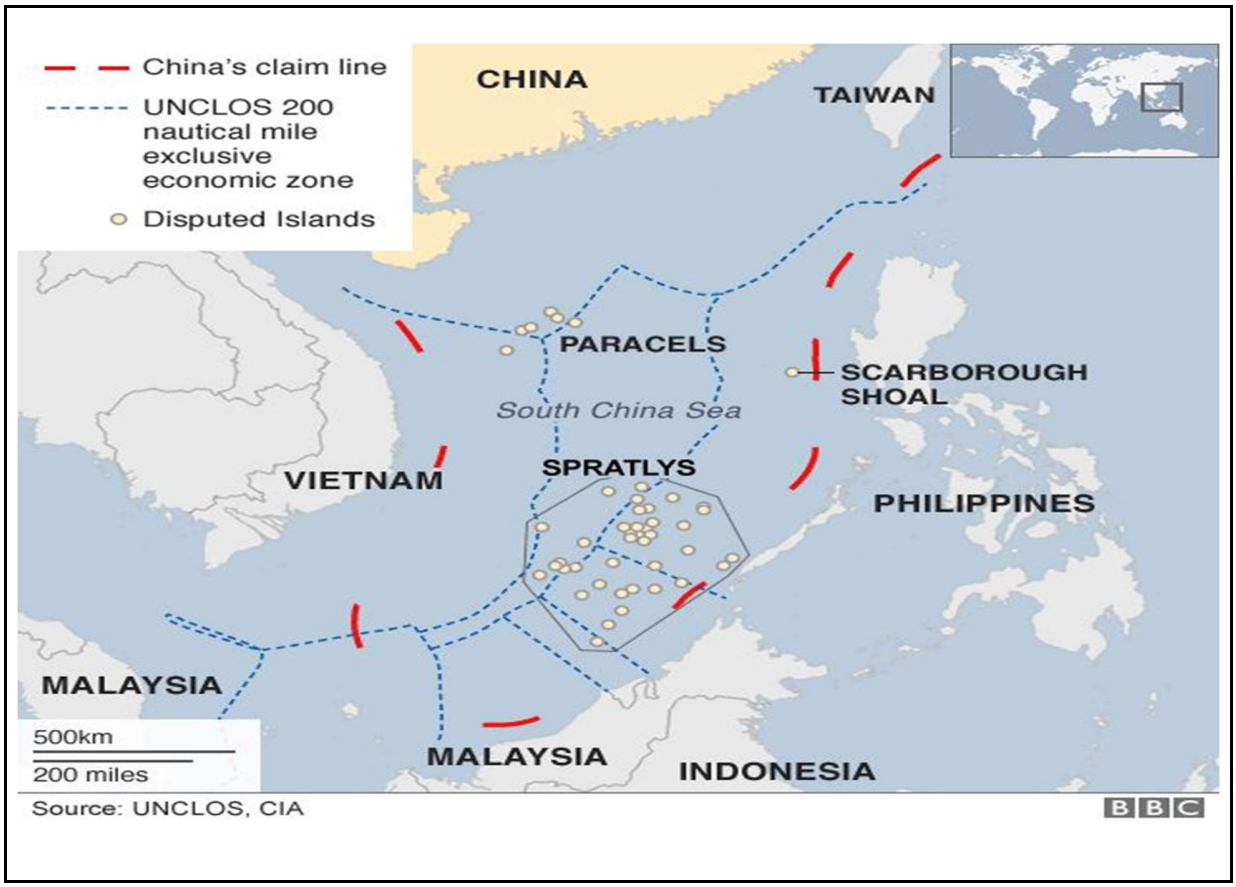


Figure 2: the Scarborough Shoal (Source: BBC, 8th May 2012)

However, confrontations continued as negotiations failed to reach an agreement satisfactory to both sides. From 2012 to 2016, there were many instances of tension between the two countries, bringing diplomatic relations to their lowest point since they were established in June 1975 (Castro, 2015). These include:

1. Incidents involving coast guard and fishing vessels: There were several incidents in 2013, 2014, and 2015 where clashes between the coast guard and fishing vessels from both took place in the disputed waters, leading to increased tensions (Castro, 2016).
2. Confrontation on the International Stage: In January 2013, the Philippines submitted its claims of the SCS islands to the Permanent Court of Arbitration in the Hague, challenging China's territorial claims in the South China Sea. This has greatly angered China, prompting it to take steps to reinforce its presence in the region (Hong, 2016).
3. Increased military presence in the region: Since 2012, both China and the Philippines have been increasing their military presence in the region. In addition to China's actions of building artificial

islands, China's Southern Theater Command Navy has tripled the frequency and intensity of its "regular military exercise" in the region to display its military strength and presence (Cordesman et al., 2019).

Tensions between the two countries gradually eased in June 2016 following President Rodrigo Duterte, the newly elected president of the Philippines, taking steps to reduce tensions by downplaying Manila's victory in the 2016 arbitration by the Court of Arbitration (Baviera, 2016). Since then, Manila has pursued a less confrontational approach towards China with a primary emphasis on economic cooperation (Heydarian, 2018).

3.3 Economic Consequences of the Confrontation

As discussed in the previous section, liberal and realist IR scholars have very different assumptions and predictions on the impact of the territorial confrontation between China and the Philippines. For the realists, an intense confrontation such as the one between China and the Philippines will unquestionably lead to a persistent disruptive effect on bilateral trade until it has been fully resolved. On the other hand, according to liberal logic, there will be little or no disruptive effect on the economic activities between China and the Philippines, given the extensive economic ties between the two countries.

3.3.1 When the Realists are Right: Weaponisation of Trade

The economic relationship between China and the Philippines is quite asymmetric, due to the sheer difference in the size of the economy and the structure of bilateral trade. Throughout the period, little actions targeted against Chinese imports have been taken in the Philippines vis-sa-vis actions taken in China against Filipino exports. At the state level, the Chinese government issued an unofficial ban on the import of Filipino bananas and tourist visits to the Philippines immediately after the standoff. This was seen as a sign of rapidly deteriorating political tension, which generated suspicions amongst the businessmen in both countries that China was preparing for more extensive economic sanctions within the business community of the two countries. Furthermore, there were many reports of China's preparation for more sanctions in the media of both countries (Luo, 2021). The Filipino government, on the other hand, did not publicly announce any economic actions. Knowing the sheer difference between the quantity of the two economies, it instead responded to the dispute politically by welcoming more American interventions to the dispute, which raised the intensity of the conflict further (Castro, 2014).

Actors at the business and individual level in China, which realists see as an extension of the will of the state, have also taken actions that further amplified the disruptive effect on bilateral trade. As talks of boycotts and concern dominated the public discussion after each round of confrontations in 2012, 2015 and 2016 across the business community and the public. In China, the Secretary General of the China-ASEAN Council told reporters in May 2012 that many Chinese businesses have expressed "concern" over the (SCS) situation and told him that they "are withholding more investments plans or to source for alternative import sources" as they do not want to trade with the "running dog of the US (the Philippines)". (Sohu, May 2012). At consumer level, For example, in the aftermath of the 2012 conflict, Slogans such as "If you want to eat a mango, buy from Thailand" and "Filipinos to die of hunger" have been widely circulated on the Chinese microblogging site Weibo (the Jakarta Post, 2014). However, similar evidence are rare in the Philippines besides some calls for boycotting Chinese products and Chinese economic initiatives such as the BRI circulating the Filipino internet (FCBC, 2012).

3.3.2 When the Liberals are Right: Cooperation Amidst Tension

Interestingly, economic relations continued to progress despite the intensifying conflict throughout the period, as illustrated by the following measures:

1) Bilateral trade: Bilateral trade between the two states continued to grow steadily at an average speed of 10% from 2012 to 2016 amidst political tension and the alleged Chinese sanctions. In 2012, China became the third largest trading partner of the Philippines and climbed to the position of second in 2013 (Philippines Statistic Authority, 2016).

2) Investments: Chinese companies continued to invest in the Philippines despite the South China Sea dispute. For example, in 2014, China's state-owned CITIC Group invested $1.5 billion in an integrated iron and steel manufacturing plant in the Philippines, the largest Chinese investment in the Philippines since 1979 (China OFDI Data Base, 2015).

3)Attitude towards the Belt and Road Initiative (BRI): Despite the tense relationship, President Aquino III attended the signing ceremony for the Articles of Agreement of the Asian Infrastructure Investment Bank (AIIB) in Beijing in 2015 and signed on as the last founding member of the AIIB. This move has surprised many observers of the SCS dispute as it went against Aquino III's previous promise to reduce economic dependency on China (Baviera, 2021).

Hence, the China-Philippines dispute over the SCS presents itself as a complex case study to the debate between the liberals and the realists as elements of both theories exist in the bilateral relations even as China becomes more assertive. The presence of both liberal and realist predictions thus informed our hypothesis.

3.4 Hypothesis

As discussed previously, the economic relationship between China and the Philippines is an asymmetric one where the Philippines did not really impose any trade restrictions on Chinese exports to the Philippines, nor did we find any evidence of long-lasting consumer boycott of Chinese good in the country. Hence, this paper will examine the effect of the conflict on bilateral trade with a special focus on the effect on Filipino export to China.

Hypothesis 1: The territorial dispute between China and the Philippines produced a significant negative treatment effect Filipino export to China in the aftermath of the conflict.

Previous works on the topic have often found that severe political tension often produces a significant negative externality on bilateral trade in the immediate aftermath of the dispute. Immediately after the conflict, reports inundated media platforms of both countries about the Chinese import ban on Filipino imports, which caused a significant reduction in Filipino agricultural export. This fits the realist perspective that China has weaponised bilateral trade to punish the Philippines. In addition, there were also reports such as consumer boycotts and businesses withholding their investments in China (Politico, 2012). Hence, we expect the territorial dispute between China and the Philippines to have a deteriorative effect **on** Filipino export to China in the immediate aftermath of the conflict. Building on previous scholarships, immediate aftermath is defined as the first six month after the conflict.

Hypothesis 2: The negative treatment effect caused by territorial disputes is persistent throughout the whole duration of the dispute.

While previous found that political conflict does not fundamentally alter the direction of economic relations as the negative impact is short-lived (Du et al. (2017); Wang Fang (2015); Whitten et al. (2020), the increasing nationalistic China since early 2012 might have changed this conclusion as China migh have adopted a more realist approach. Hence, this paper expect that the treatment effect of trade caused by territorial disputes would be persistent throughout the entire duration of the dispute from 2012 to 2016.

Both hypotheses will be tested in the next section using the SDiD model.

4 Research Design[1]

4.1 The Synthetic Difference-in-Differences Model

The SDID is the most recent method to estimate causal effect with panel data that combines the strength of the Difference-in-Differences (DID) and Synthetic Control Methods (SCM). The SDiD model requires a strongly balanced panel with N units and T time periods. Y_{it} denotes the outcome for unit i in period t. $W_{it} \in \{0, 1\}$ denotes the exposure to the binary treatment. N_{co} denotes the number of sizes of the donor pool, hence (N- N_{co}) is the number of treated units, which are exposed to the treatment after time T_{pre}. For this paper, the treatment is the outbreak the SCS dispute between China and the Philippines on 10th April 2012. The outcome variable is the China-Philippines bilateral trade volume since the outbreak of the conflict, April 2012 to June 2016, where the conflict ended.

The comparison of the SDiD, DiD and SCM methods can be listed as follows:

$$(\widehat{\Delta\tau}^{sdid}, \widehat{\mu}, \widehat{\alpha}, \widehat{\beta}) = \arg\min_{\tau,\mu,\alpha,\beta} \left\{ \sum_{i=1}^{N}\sum_{t=1}^{T} (Y_{it} - \mu - \alpha_i - \beta_t - W_{it}\tau)^2 \widehat{w}_i^{sdid}\widehat{\lambda}_t^{sdid} \right\}. \quad (1)$$

$$(\widehat{\Delta\tau}^{did}, \widehat{\mu}, \widehat{\alpha}, \widehat{\beta}) = \arg\min_{\tau,\mu,\alpha,\beta} \left\{ \sum_{i=1}^{N}\sum_{t=1}^{T} (Y_{it} - \mu - \alpha_i - \beta_t - W_{it}\tau)^2 \right\}. \quad (2)$$

$$(\widehat{\Delta\tau}^{sc}, \widehat{\mu}, \widehat{\beta}) = \arg\min_{\tau,\mu,\beta} \left\{ \sum_{i=1}^{N}\sum_{t=1}^{T} (Y_{it} - \mu - \beta_t - W_{it}\tau)^2 \widehat{w}_i^{sc} \right\}. \quad (3)$$

There are three advantages of the SDID method that make it especially applicable to our analysis. Firstly, like SCM, it assigns unit weights ($\widehat{w}_i^{sdid}$ and $\widehat{w}_i^{sc}$) to the control units based on pre-treatment data to produce more realistic counterfactual trends than the DiD method. The donor pool is the group of untreated units selected to construct the synthetic control unit, which presents the counterfactual for the treated unit. The logic behind the donor pool is to find a combination of untreated units that closely resemble the treated unit in terms of pre-treatment characteristics and outcomes, allowing for a more

[1] All data and code are available upon request.

accurate estimation of the treatment effect. As stated above, the treatment of interest for this paper is the outbreak of the conflict since the standoff. To measure its treatment effect, this paper chooses countries that closely resembles the trends of bilateral trade between China and the Philippines but were not involved in political dispute with China to construct a convincing "synthetic bilateral trade flow" from this donor pool.

Secondly, the SDID is superior to the SCM and DiD in a number of ways. Compared with DiD, the SDiD relaxes the parallel trends assumptions that traditional DiD methods are based, allowing it to be applied to cases where the pre-treatment trends are not parallel. Compared with the SCM, SDiD can be applicable to large numbers of treatment units or when the outcomes of the treated units are extreme to the donor pool, which are not applicable to the traditional SCM as the method allows a parallel gap between the actual trend and synthetic trend of the treated units instead of the SCM which requires a minimisation of the distance in-between the two trends. Furthermore, unlike the SCM estimator, the SDID estimator includes unit fixed effects which accounts for the gaps in the parallel trends between units rather than leaving the gaps in the error terms. This is especially important for our analysis, as it is difficult to find enough countries in real life that closely resembles both the volume and trends of bilateral trade flows to that of China and the Philippines.

Furthermore, what really sets the SDID estimator apart from the DiD and the SCM is the incorporation of time weights λ_t^{sdid} into the model. The SDiD estimator calculates time weights for periods before treatment in order to minimise the *difference in discrepancies* between the post-treatment outcomes and the weighted pre-treatment results across control units.

4.2 Assumptions

1. No Other Idiosyncratic Events Assumption: The model assumes that the unobserved transitory shocks are "independent across units and in time" (Ferman & Pinto, 2016). This means that no unit substantially undermines the model's predictability, and no events other than treatment dramatically impact the trend. In our case, the territorial dispute between China and the Philippines must be the only factor affecting their bilateral trade.

2. Parallel Trends Assumption: the underlying trends in the outcome of the treatment group and the control group must be parallel in the absence of the treatment. In our case, this means that the outcome for both groups would have followed the same path (both experience a decrease or increase in bilateral trade with China) in the absence of the treatment (conflict).

3. Assumption of Independence and Exclusion Restriction: The treatment and control groups must be independent and not influenced by each other. This means that the countries in the control group must not have spillover effects or contamination between the two groups. In our case, countries in the donor pool must not be affected by the territorial dispute between China and the Phillippines.

4. The Existence of Weights Assumptions: there is a "stable linear combination of the control units that absorbs all time-correlated shocks" (Ferman & Pinto, 2016). This means that we can produce a counterfactual of interest based on a linear algorithm and past data of the sample units.

4.3 Population of Interest, Identification Strategy, Time Span and Data Sources

4.3.1 Time Span

The time span of interest for this research is April 2012 to June 2016. As explained previously, April 2012 is used as the starting point as it was the starting point of the direct clashes between China and the Philippines in the Scarborough Shoal. It ended in June 2016 as the new President of the Philippines, Rodrigo Duterte, came into office and took steps to de-escalate the tension (International Crisis Group, 2021).

4.3.2 Identification Strategy

Unlike linear regression models that favour large sample size the SDiD model requires a donor pool of comparison units that bear certain similar characteristics. Hence, this precludes conventional ways of sampling (such as random sampling), and requires careful selection by the researcher according to certain criteria.

Arkhangelsky et al. (2021b) suggest four criteria for the donor pool of comparison units:

- First, units affected by the intervention of interest or similar interventions should be excluded from the pool.
- Second, units with idiosyncratic shocks during the study period should be excluded from the pool.
- Thridly, the size of the donor pool should be relatively small to avoid overfitting.
- Lastly, unites selected should display similar trend of changes as the control unit in possible covariant factors that might affect the treatment.

4.3.3 Countries Selected for the Donor Pool:

In the paper analysing the impact of the SCS dispute on bilateral trade between China and ASEAN trade, Muhammad and Maddaremmeng (2019) used all other ASEAN countries that do not have a territorial dispute with China as the control group. This is because, the authors believed that as they are neighbouring countries within the same region and organisation, they are likely to resemble the Philippines closely (Muhammad and Maddaremmeng, 2019). Hence, this paper similarly chose all other ASEAN countries that did not have a direct confrontation with China as my donors. However, this paper has included three claimant countries, Malaysia, Brunei and Indonesia, in the donor pool for two reasons. Firstly, since the treatment of our study is the outbreak of a direct confrontation with long-lasting effects across the two countries, the disputes that have taken place between the three countries are in no way comparable to our treatment, as there was no outbreak of major conflict between China and these three states within the period of analysis. Moreover, Wang (2015)'s paper has proven that low-level conflicts, such as diplomatic complaints and verbal exchanges between the two governments (for instance, the disputes that took place between China and the Philippines in 2009 and 2011) do not assert a significant impact on bilateral economic activities. Hence, these countries are included in the donor pool, although they are clamant countries.

Thailand	Myanmar	Cambodia
Singapore	Indonesia*	Laos
Brunei*	Malaysia*	

Table 1: List of Donor Pool

4.3.4 Data Sources

The data sheet contains the quarterly trade data between China and nine Southeast Asian countries. The quarterly bilateral trade (current US dollars) data are calculated from the monthly bilateral trade data from the custom database from China, the Philippines and the respective countries in the control group.

4.4 Treatment and Predictors

The treatment/intervention of interest is the "direct clashes between China and the Phillippines in the Scarborough Shoal" in April 2012. The time of treatment (April 2012) constitutes the cut-off point (T_0) in the model between the pre-treatment period (1,..., T_0) and the post-treatment period(T_0+1,...,T).

The predictors for the trade volume of the "synthetic bilateral trade" (control unit) are the quarterly bilateral trade (current USD) of the donor pool.

4.5 Dependent Variable/Outcome Measurement

The dependent/outcome variable (Y) is the (logged) volumes of bilateral trade, Filipino exports to China and Chinese exports to the Philippines between China and the treated and control unit countries between April 2012 and June 2016. This is measured in USD at current exchange rates.

5 Results

We assessed the impact of the 2012 clash on Filipino exports to China with three estimators. The results are presented in Figures and tables below. Contrary to our Hypothesis 2, all three estimators indicate a statistically insignificant treatment effect (ATT) of the 2012 clash on bilateral trade between China and the Philippines throughout the period of analysis. (see Table 2). Both the SC and SDID estimators show similar synthetic trends and sizes of the ATT, which implies the robustness of our results. P-values in Table 2 suggest that all three estimated coefficients are statistically insignificant at any conceivable levels. According to the table, the overall fluctuations of the Filipino exports to China comply

with that of the synthetic counterfactual from which the clash was absent. This means none of the three estimators found evidence that the Filipino exports to China had been affected by the territorial conflict. The estimated ATT of bilateral trade are -0.121, -0.425 and -0.156 respectively for the SDID, DID and SC estimators. The corresponding visualisations are in Figure 3. All three estimates are statistically insignificant at any conceivable significance levels. This indicates that this paper does not find evidence to prove that the confrontation due to the SCS dispute asserted a significant impact on Filipino exports to China for the time span of this study. It is worth noting that the SDID estimate is the smaller than the DID and SC estimates, implying that the significant results from the previous literature using these two estimators could have been biased by transitive shocks and unparallel trends to which the SDID estimator is more resistant.

	SDID	DID	SC
ATT	−0.121 (0.468) [−0.702, 0.430]	−0.425 (0.460) [−6.786, 6.068]	−0.156 (0.618) [−7.816, 7.536]
FE: Country	Yes	Yes	No
FE: Time	Yes	Yes	Yes
Effective N	486	891	594

* p < 0.1, ** p < 0.05, *** p < 0.01

Note: P-values in parentheses, CIs in square brackets, all calculated through Wild Cluster Bootstrapping (WCB) by country with Webb weights. Effective observations for SC and SDID are smaller due to zero time and unit weights.

Table 2: Result table for DiD, SCM, and SDiD estimates of the effect of the SCS dispute on Filipino exports to China.

As explained in the previous section, the synthetic trade flow is constructed by assigning weights to countries in our donor pool by how closely each country can represent the trend China-Philippines trade in the pretreatment period. Figure 3 shows that as compared to the Synthetic Control Method, there is a relatively even weight assigned across our donor pool, as indicated by the size of the dots. This increases the credibility of our synthetic trade flow as we do not have the risk of overrepresentation of the sample by one or two countries.

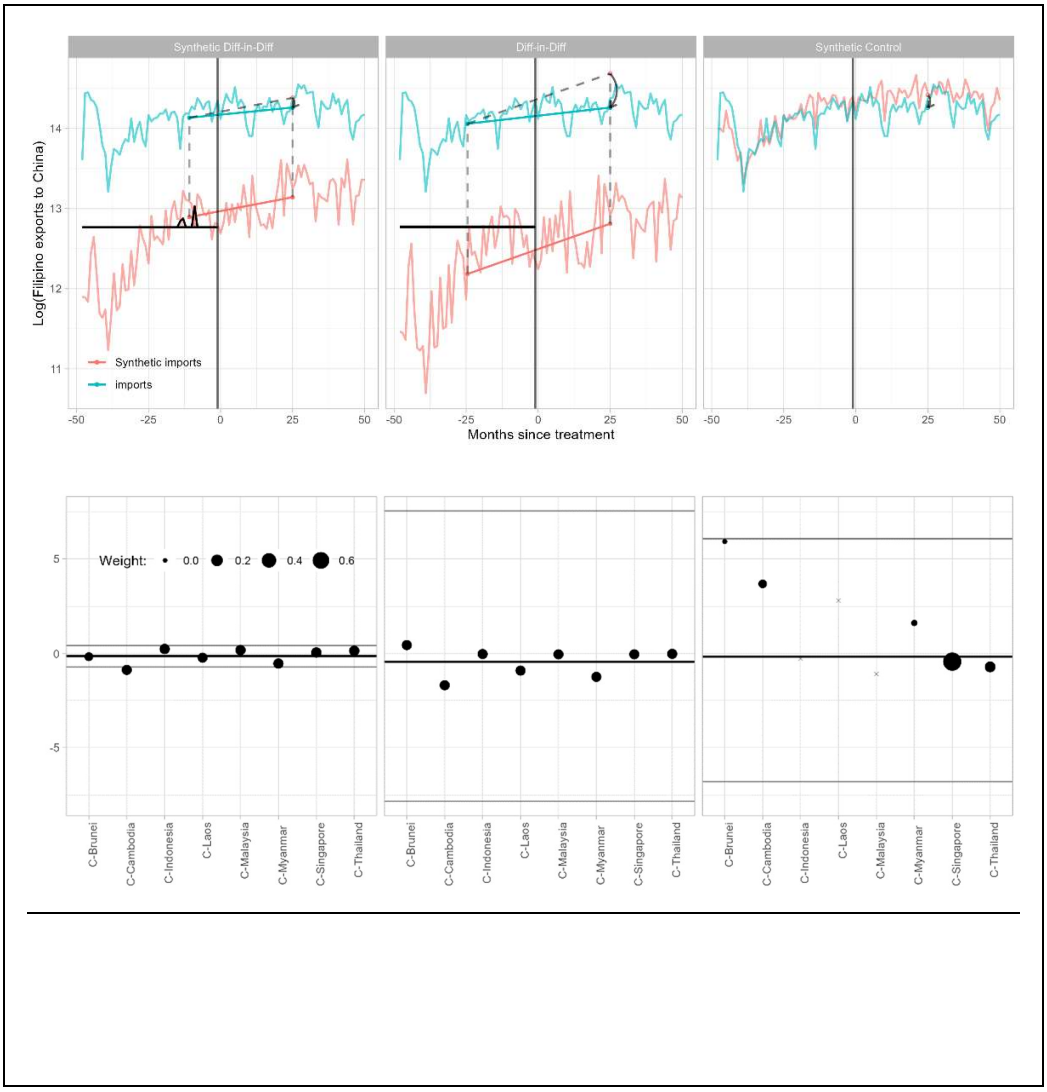


Figure 3: A comparison between DiD, SCM, and SDID estimates for the effect of the SCS dispute on Filipino exports to China. (Note: Time weights are at the bottom of the graphs; arrows and parallelograms are drawn based on (time) weighted averages. The second row shows the adjusted outcome difference $\widehat{\delta_{tr}} - \widehat{\delta_{i}}$, with the unit weights $\widehat{\omega_i}$ indicated by dot size and the weighted average of these differences —the estimated differential effect — indicated by a horizontal line. Control units with zero weight are denoted by an ×-symbol. Confidence intervals are displayed in grey horizontal lines.)

One may wonder how if the ATT varied overtime, specifically, if there was indeed a negative treatment effect on bilateral trade in the immediate aftermath of the clash as predicted in hypothesis 1. Therefore, we provide an event study style plot for the SDID results with 90% and 95% confidence intervals in Figure 4 and a corresponding result table in Table 3. The SDiD result presented in an event study style plot shows the estimated effect of the 2012 clash on bilateral in the first six month after the outbreak of the tension. Contrary to Wang's finding, we found neither a significant impact nor a negative impact.

The non-negative estimated ATT for the first six months dismiss concerns about Type I errors in our study whereby the null result arised from low statistical power rather than no impact.

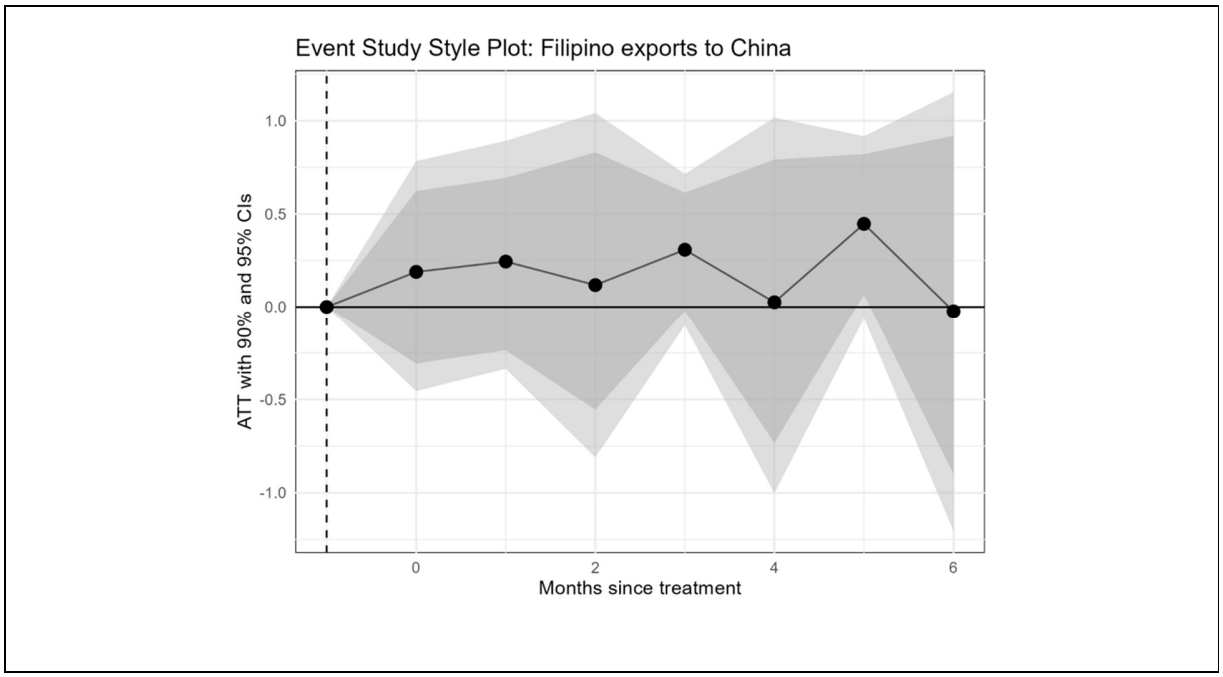


Figure 4: Event-Study style plot for the ATT on Filipino exports to China over time.

	ATT by month
0	0.189 (0.372) [−0.455, 0.784]
1	0.245 (0.316) [−0.336, 0.892]
2	0.118 (0.708) [−0.810, 1.042]
3	0.308 (0.117) [−0.101, 0.715]
4	0.026 (0.938) [−1.002, 1.017]
5	0.447 (0.066)* [−0.062, 0.917]
6	−0.023 (0.946) [−1.204, 1.153]
FE: Country	Yes
FE: Time	Yes
Effective N	486
R2	0.921
R2 Adj.	0.897

* p < 0.1, ** p < 0.05, *** p < 0.01
Effective observations for SDID are small due to zero time and unit weights.
CIs are calculated through Wild Cluster Bootstrapping by country with Webb weights.

Table 3: Result table for ATT on Filipino export to China over time.

6 Robustness Check

6.1 Placebo Test

The robustness of the SDiD estimator relies on whether its assumptions are violated. A common way of assessing this is a placebo test whereby the pre-treatment period is divided into two halves; the SDiD model is then trained on the first half to predict the second half. The alignment of the predicted trend with the actual trend would imply the robustness of the model. In this case, we divide the pretreatment period of 48 months into two 24-month periods with the placebo treatment date being April 2010.

The visualization of the placebo test can be found in Figure 5. Figure 5 suggests that the predicted trend matches the actual trend reasonably well[2]. As shown in Table 4, the estimated placebo treatment effect of -0.066 is very close to zero and is not statistically significant at any conceivable levels (P=0.512). The results indicate that the SDiD estimator is robust for this study.

[2] The parallel gap between the two can be ignored for it is irrelevant in inference.

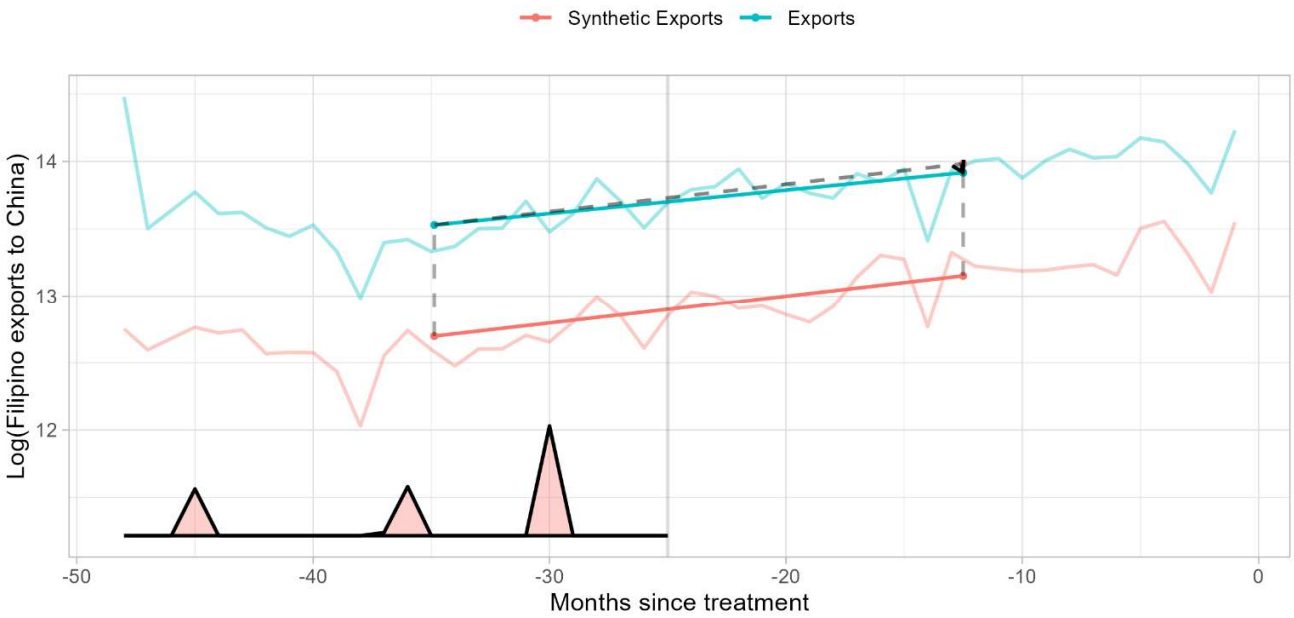


Figure 5: SDiD plot for the actual and predicted pre-treatment trends. (Placebo treatment at period -24)

	Placebo
ATT	−0.066 (0.512) [−0.415, 0.293]
FE: Country	Yes
FE: Time	Yes
Effective N	252
R2	0.980
R2 Adj.	0.976

* p < 0.1, ** p < 0.05, *** p < 0.01
Effective observations for SC and SDID are smaller due to zero time and unit weights.
CIs are calculated through Wild Cluster Bootstrapping by country with Webb weights.

Table 4: Result table for the SDiD placebo test. P-value in parentheses, 95%CI in square brackets.

6.2 Alternative Estimator: Dynamic-Multilevel Latent Factor Model (DM-LFM)

Despite using three different estimators (SDiD, SCM and DiD) in the main analysis, we also use the Dynamic-Multilevel Latent Factor Model (DM-LFM) as a further robustness check. Pang et al. (2022) developed the DM-LFM as an alternative estimator for causal inference with binary treatments and panel data to other SCM-stemmed counterparts[3]. We selected the DM-LFM estimator as the robustness check for its uses of the Bayesian framework, in stark contrast to the three frequentist estimators used in our main analysis. Pang et al. (2022) argue that the combination of the Bayesian approach and the latent factor model can better extract information from the data and thus provide more precise estimates.

The results from the DM-LFM are shown below. Figure 6 compares the actual trend of Filipino exports to China with a counterfactual without the SCS dispute predicted by the DM-LFM, with the 95% credible interval in grey for the Bayesian posterior prediction. The difference between the two trends are summarized in Figure 7, which indicates the prediction errors for pre-treatment periods and the estimated effect over time for the post-treatment period. The DM-LFM does not find evidence for a statistically significant effect of the SCS dispute on Filipino exports to China (see Table 5), in line with the main analysis. One should not be confused by the positive coefficient as it is small in magnitude and can be attributed to the positive estimated treatment effects in the later stages of the post-treatment period, as suggested by Figure 7.

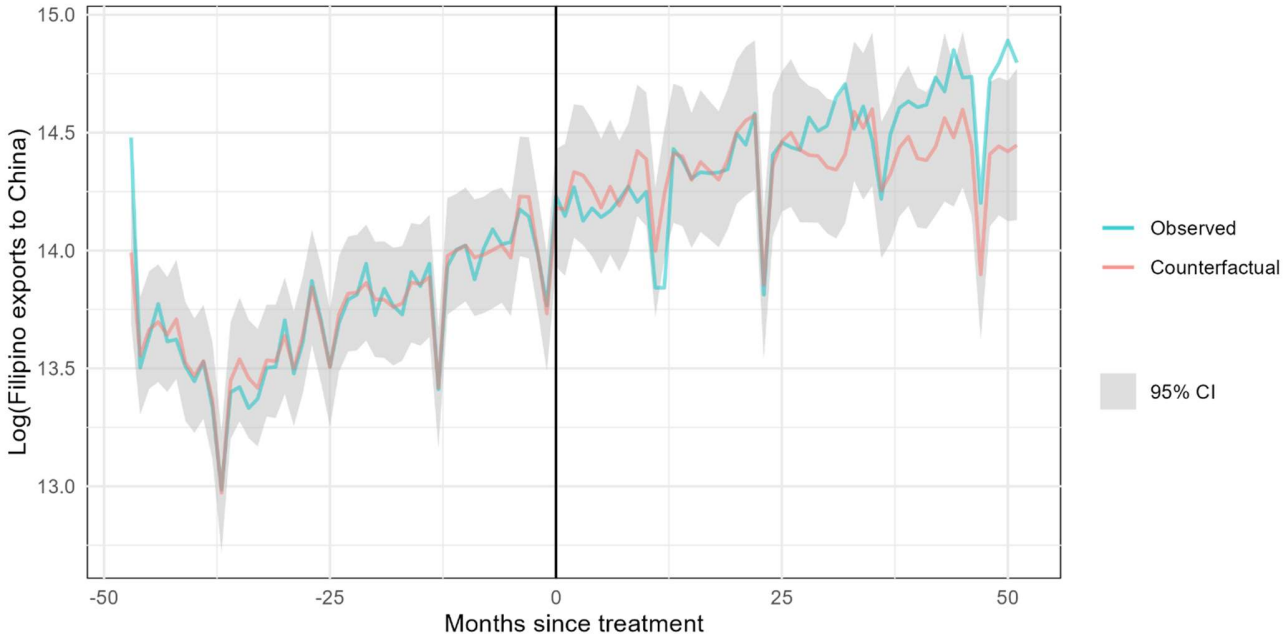


Figure 6: Plot for the actual trend of Filipino exports to China and the counterfactual trend without the SCS dispute predicted by the DM-LFM.

[3] The SDiD estimator also belongs to this category.

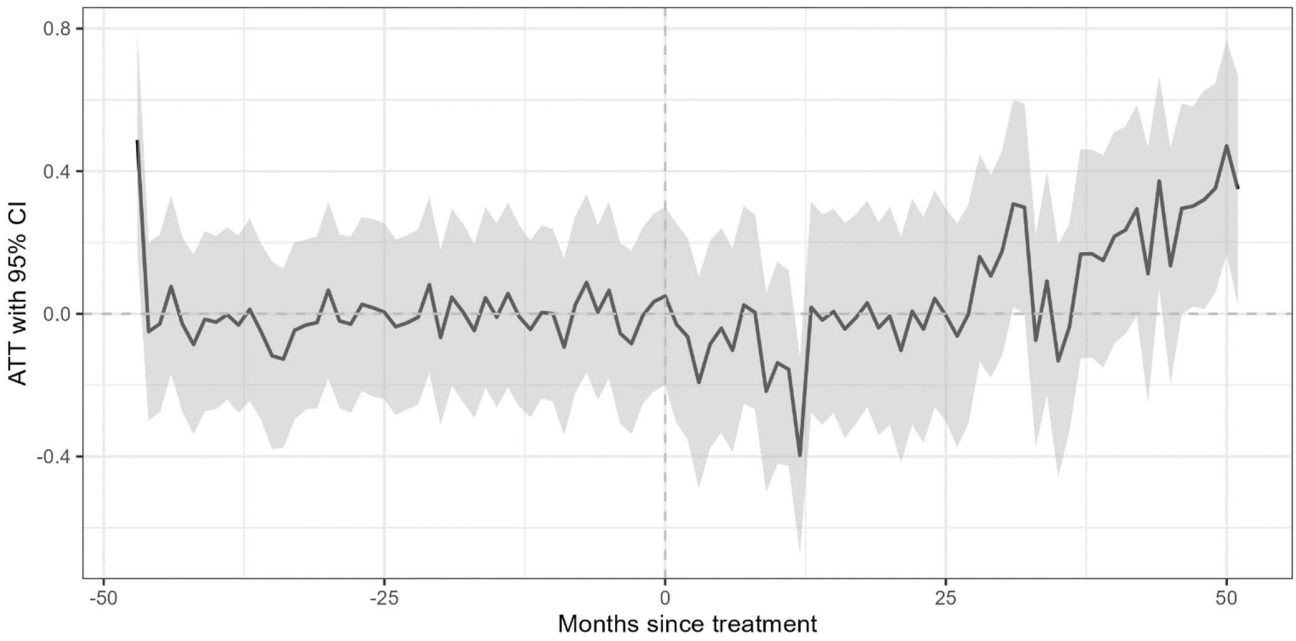


Figure 7: Effect of the SCS dispute on Filipino exports to China over time. (95% CI in grey)

	DM-LFM
ATT	0.063
	[−0.057, 0.183]
Observations	891
Treated Units	1
Control Units	8

Table 5: Result table for the DM-LFM estimate of the effect of the SCS dispute on Filipino exports to China. (95% Credible Interval in square brackets)

7 Discussion

Although the estimated coefficients for the 2012 clash (see Table 2) are negative across different estimators, they are far from being significant. One possibility is that we have made a Type I error, in which case the result is a false negative; the other explanation is that the clash really had no effect on Filipino exports to China between 2012 and 2016. We argue that the latter is more likely to be true.

The primary evidence against the Type I error explanation is that the estimated coefficients for ATT in the first six months are positive, as shown in Table 3 and Figure 4. This means that, according to the SDID estimator, Filipino exports to China did not fall below the synthetic counterfactual trend in the immediate aftermath of the 2012 clash.

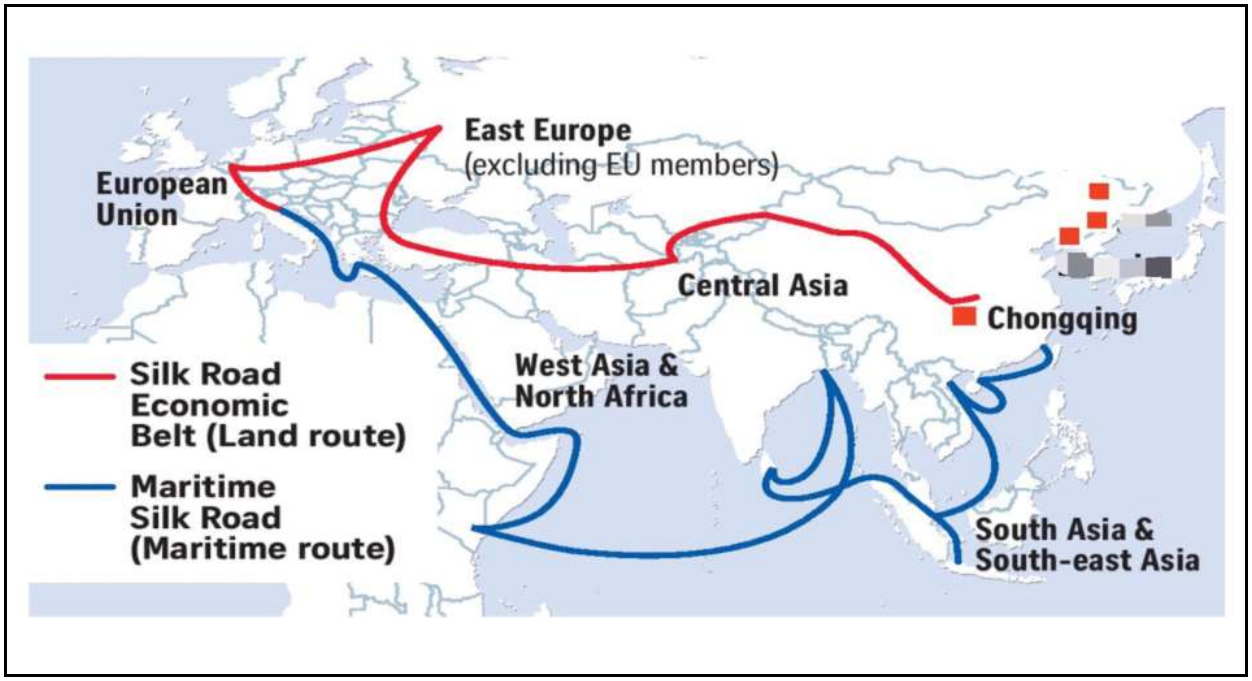
Furthermore, the synthetic and actual trends display similar patterns after the immediate post-treatment period (from 2013 to 2016). This largely complies with previous scholarships (Wang, 2015; Du et al., 2017).

Why didn't China, perceived to be increasingly nationalistic and realist in its foreign policy, leverage its asymmetric economic strength to penalise the Philippines as anticipated by realist theory? We suggest several factors which might explain this at different levels.

In the short run, while calls of war has inundated the Chinese internet, and Chinese new media's such as the Global Times, China Daily and Xinhua News Agency have repeatedly issue hardline statements and warned Philippines of potential economic sanctions, in reality, stricter control on banana import and travel warning against group tourism were the only two actions taken by the Chinese government. In May 2012 alone, China not only denied 150 containers of bananas from entering its markets, citing that the bananas were "crawling with insects", but also cancelled all tourist groups to the Philippines (The Manila Bulletin, 2012). The decision was interpretated by as " China's attempt to punish the Philippines economically" (Politico, 2012). There were also many reports of China's preparation for more sanctions in the media of both countries (Luo, 2021). Filipino banana exporters are highly dependent on the Chinese market, as China consumed nearly 85% of Filipino bananas in 2011. However, it only constitutes 1.23% of Filipino exports to China in the same year (Philippine Statistics Authority, 2016), which might not have affected the overall trend and flows of bilateral trade between the two countries. Despite the signaling effect of the banana and tourist ban, in the absence of direct sanctions, it is likely that businesses in the two countries did not simply *follow the flag* but waited to see how the conflict developed. Additionally, earlier studies like the one by Li et al. (2019) have identified a lag time of between two to four quarters before the impact of bilateral conflicts becomes noticeable on trade flows, as the market needs time to react to changes in political relations. Furthermore, the Chinese government, while putting up a high rhetoric on the issue, has adopted a cautious attitude in taking further actions against the Philippines, especially in terms of furthering economic punishments towards the Philippines. This might be due to the fact that China is preparing for its upcoming leadership renewal and did not want the negative repercussion of the conflict to persist to 18th Party Conference that is going to take place in October in the same year. These factors might have provided some explanations of why there was no significant negative effects on Filipino export in the short run.

In the long run, existing evidence suggests that since the beginning of the conflict in 2012, efforts have been made by both governments to reduce the disruptive effect on bilateral economic activities, as both countries faced the dilemma of carefully balancing their territorial mandate and the need for economic cooperation. From the Chinese perspective, For China, the increasing need for projecting its economic power abroad, especially since the launching of the Belt and Road Initiative (BRI) in 2013 and the realisation of the amount of damage brought by its actions on its image might have made it aware the limit of its assertiveness on international stage.

Figure 5: One Belt One Road Map



(Source: The Straits Times, 3rd March, 2016)

While the BRI is appealing to most of the SEA countries facing a huge gap in their infrastructural development that significantly hindered economic development in the region (Wong, 2017), they are hesitant to fully embrace the initiative. From the perspective of the Philippines and the SEA countries, numerous scholars have pointed out the struggle they face to strike a balance between their economic interest and geopolitical concerns in the context of the rising China and the escalating SCS dispute. Given the context of the geopolitical uncertainties wrought by China's rise, SEA countries, especially the other four claimant countries often viewed China's action towards the Philippines as an indicator of China's foreign policy as a whole. Thus, aggressive actions of China creates fears within SEA countries that China would take advantage of their increasing economic dependence on China and force them to concede to its political demands, which might have discouraged them into establishing closer economic relations with China (Nie, 2016). This is fully demonstrated by the ASEAN 2012 statement which states that while ASEAN states 'look forward to bringing China-ASEAN cooperation to the next level', they cannot ignore the concerns about 'what is happening in the SCS' (Thayer, 2014).

Hence, the region's fear sparked by its assertive policies and the negative implications on the promotion of the BRI, might have provided the Chinese leaders with an incentive to restrain the level of assertiveness towards the Philippines. From the Filipino perspective, President Aquino III was also aware of the sheer disparity between the state power of the two countries, as well as the massive gap in infrastructure at home and the lack of alternate sources of funding made both the BRI and the AIIB especially appealing to the country (Hu, 2017). This might have also provide him with the incentive to not escalate the matter further.

In fact, efforts to contain the spillover effect of the territorial dispute can be observed by since beginning of the conflict. For example, in 2014, the spokesman of the Filipino Foreign Ministry emphasised that the two governments have agreed that "the South China Sea dispute should not be the sum total of their relations" and that they will "abstract the South China Sea dispute for separate treatment (Baculinao, 2014)." President Aquino III reinforced this stance during his short meeting with President Xi in 2015, where he said that "we would rather concentrate on activities that will improve the lives of our people" (ibid). In the same meeting, President Aquino III signed on as the last founding member of the Asian Infrastructure Investment Bank (AIIB) in 2015, a move against the warning of the US and Japan that surprised many observers of China-Philippines relations.

Similar efforts was also observed on the Chinese side, where President Xi emphasised that China is willing to adopt a "pragmatic approach" on the issue "contain disagreements for cooperation" hoped the two sides would “move in the same direction and constructively deal with it” during the meeting of the two presidents in 2014. Following the meeting, the Chinese Embassy in Manila emphasised that "the Philippines is an integral part of China's BRI in Southeast Asia" (Vera Files, 2014; Hu, 2018). This shows that efforts have been made on both sides to contain the spillover effects of the territorial dispute to the sphere of economic cooperation.

In that perspective, the targeted import ban on Filipino bananas was more of a warning to the Philippines rather than a prelude to broader trade sanctions. In this case, Chinese ban on the banana was seen as a strategic move to warn the Philippines, as Bananas imported by China was the mainstay of the economy in the region around Davao City, of Mindanao, that has undergone a series of Marxist insurgencies led by the New People’s Army (NPA) since the 1980s. Just as China has issued the ban on Banana, in other areas of Mindanao, the Philippine military, supported by U.S. troops, was combatting a rising insurgency by Muslim extremists. According to Bangoy, a banana grower near Davao City, stated that economic growth from bananas reduced NPA guerrilla appeal in his region, but warns they might return if Chinese import restrictions bankrupt growers. This strategic choice puts pressure on the Philippines government, while not causing dramatic disruptions on bilateral economic activities (Higgins, 2012). The act of targeting specific selected industries where pain will be felt, yet the spillover effect is limited, has also been observed in other instances of conflict with China. When political tension arose between China and Australia after Prime Minister Scott Morrison's accusation of China's human rights record and South China Sea policy, China similarly introduced an import ban on Australian coal imports in 2020. However, China-Australia bilateral trade remained largely unaffected, as the export of Australian coal constituted only 1% of its total export to China (The Diplomat, 2023). By doing so, China can balance its need to warn the other party of the economic cost it might face if tensions continue to escalate while containing the spillover effect to the whole bilateral trade, which generates benefits for both parties.

At the level of business and individuals, evidence of business lobbying can be found in the Philippines, which was said to have pressured the Filipino government to take steps to limit the disruptive effect. Since 2012, Sergio Ortiz, president of the Philippine Exporters Confederation, has issued serval warnings to the Filipino government that the Filipino exporters are "extremely worried about the worsening of bilateral relations" (The Financial Times, 2012). He has called for the Filipino government to reach “quick resolution to the month-long stand-off with China in order to reduce the losses suffered by Filipino exporters(ibid). Similar calls have also been made by the Pilipino Banana Growers and Exporters Association, warning up to 200,000 banana farmers and ancillary workers could lose their livelihood if resolutions are not been reached quickly. (the Philistar, 2012). Similar evidence could not be found in China. Given the authoritarian nature of the Chinese political system, it is unlikely that the business body could pressure the central government. However, from 2013 onwards, businessmen from both sides quickly resumed their trade activities with each other, especially when the Chinese vice minister of Commence made a public statement in late 2013 that "I can assure everyone that sanction is not our national policy" (Xinhua Net, 2013). Words of assurance from governments were said to have greatly restored business confidence (Xinhua Net, 2013). This shows even if the businesses are not capable of influencing the decisions of governments, and they do not simply "follow the flag" and cease trade with hostile governments. Instead, benefits from bilateral trade motivated them to resume trade once assurance from governments was given. At the level of individuals, while calls for boycotting Filipino goods have inundated the Chinese internet in the immediate aftermath of the clash in 2012, the nationalistic comments did not last long, as little evidence could be found from 2013 onwards.

The combined efforts of the governments, businesses and individuals in both countries thus explain the continuous progression of bilateral trade.

8 Conclusion

This study attempts to contribute to the realist and liberal debate on the trade-conflict nexus by empirically examining how the South China Sea dispute has disrupted bilateral trade between China and the Philippines from April 2012 to June 2016. Our finding found no significant results on Filipino export to China throughout the period of analysis, despite the conflict remaining unresolved. This finding aligns with the prediction of the liberal school and previous works on the topic (Wang, 2015; Du et al., 2017). While Wang (2015) attributed the phenomenon to China's reliance on Filipino exports, this paper instead believes that China's practical need to promote the BRI initative in the region constrained China's aggression towards the Philippines. More specifically, Chinese policymakers understood the fear and resistance that might be created amongst SEA countries towards China if it did not contain the level of aggression towards the Philippines.

This study contributes to the existing scholarship in a number of ways. First, this paper is the first in the international political economy field to use the newly invented method of the SDiD to analyse the effect of political shock on bilateral trade flows. As explained in section 3, this new method is mathematically superior to previous commonly used methods such as SCM and DiD. Hence, this improves the accuracy of our results. Furthermore, this paper contributes methodologically by combining quantitative methods with qualitative explanations. While mainstream quantitative research often solely focuses on constructing models, this study incorporates primary resources like speeches from political leaders, corporate representatives, and public reactions during the conflict to explain the findings of the

model. By doing so, the paper addresses the limitations of existing quantitative research that often lacks a compelling explanation of the mechanisms driving the results. This combined approach provides a more comprehensive understanding of the interplay between political conflicts and economic activities and how they are influenced by various actors and public sentiments.

Third, this paper contributes theoretically by showing the applicability of liberal IR theory to a non-liberal state. While China is arguably an authoritarian country in its domestic political structure, our finding shows that its foreign policy still be explained by liberal predictions, as showcased by the business-as-usual model.

Lastly, there are empirical contributions of this paper too. In contrast to the commonly argued perspective that China has become more politically assertive in its foreign policy, this paper found that the disruptive effect on bilateral trade brought by the territorial dispute is still short-lived. This shows that China's foreign policy is still driven by rational calculation of cost and benefit rather than nationalistic fervour. It suggests that economic factors are significant in China's foreign policymaking. This sheds some light on how foreign policy is made in China and what goes into the calculation of the Chinese leadership in the formulation of foreign policies. With China's rapid emergence on the global stage, its grand strategy aims to project its economic, political and military influence internationally (Denoon, 2021). This is particularly so for its immediate neighbours in East and Southeast Asia, which are the primary target of China's influence (Fisman, 2014). As a majority of them are engaged in various forms of territorial disputes with China, the uncertainty of what will happen if conflicts break out in the future creates fear amongst these countries (Fisman, 2014). Hence, by analysing one of the most severe and prolonged-lasting territorial disputes with China in recent years, my research helps China’s neighbours to better understand China's behaviour regarding territorial disputes. This can also help international actors find a more balanced and tactical strategy to engage with a rising great power.

There are two potential limitations of the paper. First, unlike the Philippines, where interviews and comments of various parties involved in the dispute (Presidents Aquino III, government officials, businessmen and individuals) can be found on public platforms, similar evidence is limited in China due to the nature of its political system. Interviews or comments made by Chinese businesses are especially lacking. Hence, it is unclear how exactly the conflict-affected the Chinese businesses, especially the SOEs' activities. For example, did businesses voluntarily reduce business activities due to a sense of nationalism, or was it because the Chinese government secretly issued notices to cut bilateral trade? This is beyond the reach of this paper and would require an in-depth interview across businesses in China. Second, there is the question of the generalisability of the findings. As the focus of this research is exclusively on China and the Philippines from 2012 to 2016, it is unclear if the findings can be applied to other cases of conflict, such as the China-Vietnam SCS dispute from 2013 to 2017 and the China-India border conflict in 2020. A generalisable result would thus require a close comparison of all recent cases of territorial disputes that China is involved in, which is also beyond the scope of this research.

In conclusion, this paper finds that the liberal school of thought offers a more accurate prediction of the impact of political conflict on bilateral trade in the case of the China-Philippines dispute over the Scarborough Shoal and its aftermath. Overall, territorial conflicts have had a significant yet short-lived disruptive effect on bilateral trade between China and the Philippines, even though the conflict remains unresolved.

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