

Trade in the Pacific: Strategies and Policies

Peter Geib

Minnesota State University Moorhead

Lucie Pfaff

College of Mount Saint Vincent

In the last few years trade agreements tend to be of regional nature rather than global reach. In the Pacific this trend is especially noticeable as China is trying to establish a closer relationship with the ASEAN member countries in Southeast Asia. Several trade agreements are aimed at increasing China's influence in the region. But China is also taking more aggressive steps to re-establish the country's historic sphere of influence. Several maritime disputes with Vietnam, the Philippines, and Japan have created cause for concern that also has implications for the United States.

INTRODUCTION

The world-wide recession following the financial crisis of 2008 has had a dampening effect on global trade. According to the McKinsey Global Institute, cross-border flows are only sixty percent of what they were before the meltdown (Coy; Foroohar). Almost every major economy is weak, making it easier for protectionism to flourish. Countries are finding ways to circumvent World Trade Organization (WTO) regulations. Many economies have turned to regional trade agreements, particularly in Asia (Kurlantzik, 2013). Trade talks themselves are no longer global but regional and local, threatening to create a hodgepodge of competing economic alliances (Foroohar).

The interest here is in regional trends in the Pacific and the agreements and disputes between China, ASEAN, Japan, and the United States in the last few years. It is the interaction between China and other Pacific countries that has had a major influence in the region.

Asia Pacific will be highly influential in the future of world trade. It is anticipated that world economic growth will be greatly impacted by the Asian region. Today, already over fifty percent of the world's economic growth comes from Asia (Interviews). First and foremost is the rise of the Asian middle classes. Asia's consumer middle class will triple in the next fifteen to twenty years to an estimated 1.75 billion people. Per capita annual income will range to over \$20,000. Additionally, an upper middle class will emerge with annual per capita incomes to \$35,000 (Interviews). This huge consumer market will have a tremendous impact on world trade in the future.

China, fully aware of this trend, has for years embarked on a proactive policy of outward foreign direct investment to insure access to commodities and natural resources, but also markets for its exports (Interviews). Regarding trade, the new leadership in Beijing continues an open trade policy. But emphasis in the Pacific has changed. China seeks to dramatically expand regional trade. In recent years, the implementation of the ASEAN-China Free Trade Area is one example of this policy (Interviews).

In the following sections, the regional trade agreements will be discussed. Part of the discussion will be the impact of the events on the United States, Japan, and ASEAN. Of major importance will be the reaction of these players and their relationship to China.

METHODOLOGY

A significant portion of this research is based on conversations with more than 350 key influencers in Shanghai, Beijing, Hong Kong, Singapore and Washington, D.C. over a period of 26 years beginning in 1988 and most recently in the summer of 2014. Interviews in the summer of 2010 were conducted with experts from the Royal Institute of International Affairs and the School of Oriental and African Studies both in London, The Council on Foreign Relations in New York, and Imprimatur, a private investment firm in London. A significant effort has also been made to examine traditional data and documents from a variety of sources when and where they were available. One author did research in China on-site in Hong Kong, Guangzhou, Shanghai, and Beijing for one month in the summer of 2012, and most recently did research in Shanghai in the summer of 2014 as well as teaching at Shanghai Finance University. The emphasis of the research was to find the latest trends in globalization strategies with a particular emphasis on cultural change as it relates to innovation. It is important to note that many of the professionals and experts in China wish to have their comments kept confidential. Therefore, we choose to respect their request of confidentiality in all cases. We have referenced and documented data where they are public. Beyond China, research interviews were conducted in Vietnam three times since 1994.

The methodology for this study where it involves interviews can be described as a focus on the policy view of key stakeholders and influencers. In general, the interviews were conducted with senior analysts from such organizations as the Economist Group in Hong Kong, Shanghai, and London, the old Bear Sterns Investment firm, Goldman Sachs, Chase Investment Bank, U.S. Chamber of Commerce, and Boston Consulting Group in at least two locations, Microsoft, and a host of other public and private professionals. The interview format did not include a formal survey, but did include structured questions. Examples of questions asked in the interviews can be found in the Appendix.

CHINA'S REGIONALISM

While the United States is trying to widen and reinforce the international trading system, Chinese efforts seem to be concentrated on pursuing a regional strategy in the Pacific. Since the mid-1990s, China has been actively seeking a closer relationship with Southeast Asia through cooperative approaches such as developing trade agreements with the countries in the region, especially the members of the Association of Southeast Asian Nations (ASEAN) (Interviews; Geib & Pfaff). [See tables in Appendix]

There are many underlying reasons for establishing closer relationships in Southeast Asia. For some time, China's efforts toward open market reforms and dealing with the crosscurrents of globalization in the form of more trade and investment were pursued, among other reasons, for the purpose of achieving membership in the WTO. Today, outward foreign direct investment is a proactive policy to insure access to commodities and natural resources (Interviews). Domestically, the new leadership is working on market reforms to increase consumer demand at home and to also advance small and medium-sized enterprises and support start-up entrepreneurs (Interviews).

Although Beijing continues an open trade policy, the emphasis has somewhat changed. China's aim today is to dramatically expand regional trade. The leadership is certainly seeking trade and natural resource-competitive advantage in the South China and East China Seas (Interviews). At the same time it becomes apparent that Beijing is trying to re-establish China's historic sphere of influence in Southeast Asia. The recent maritime disputes are a clear reflection of this reality (Interviews).

Regarding regional trade agreements, China signed a comprehensive trade agreement in 2002 to create an ASEAN-China Free Trade Area (ACFTA) within a period of ten years. With this, China's emphasis turned to ASEAN, rather than to the Asia Pacific Cooperation (APEC) framework which includes the United States (Geib & Pfaff). The establishment of the FTA between China and ASEAN created one of the world's largest trade areas. As of 2010, it encompassed 1.9 billion people, had a

combined GDP of U.S. \$6.6 billion and the total trade amounted to U.S. \$4.3 trillion (Geib & Pfaff). [See tables in Appendix]

China is now proposing the Regional Comprehensive Economic Partnership, a more mercantilist deal for Asian countries. The partnership would ask little of these countries in terms of commitment to real market-based reforms or to environmental and labor standards – in contrast to WTO rules. But it offers them greater access to China. This might advance China's regional interests, but would do little for an open, rule-based regional order (Zakaria).

President Xi Jinping and the new leadership in Beijing are willing to change the rules of the game, including in international affairs. Xi became the first foreign leader to address the parliament of Indonesia, announcing a battery of trade deals worth more than \$30 billion. In Malaysia, he spoke of better trade relations with that country and of strategic cooperation in the South Sea (Crowley). The regional strategy becomes even more visible in the more forceful approach in territorial disputes with Vietnam and the Philippines.

The history of tensions over the South China and East China Seas is not new. But what is new is a contemporary convergence of certain historical, political, and economic forces and the resulting events. The South China Sea covers over a million square miles of the Pacific Ocean from Singapore to Taiwan. The most disputed territories include the Spratly Islands, Paracel Islands, Macclesfield Bank, and Scarborough Shoal. Six major Southeast Asian nations claim rights in regard to these territories. Vietnam and the Philippines are the areas of the highest tensions (Interviews).

It is China's claim of ownership of a number of these islands, even extending claims to almost the entire South China Sea that has several countries on high alert (Kurlantzick, 2014). Vietnam has been further alarmed by new rules introduced in 2014 by Hainan Province in China, requiring foreign vessels to seek China's permission to fish, and by a reported attack on a Vietnam ship near the disputed Paracel Islands (*The Economist*, 2014, March 22).

These tensions also raise security questions for the United States. The summer of 2014 was a particularly important turning point in light of the conflict between Vietnam and China over oil rigs in disputed waters and the clashes between China and Japan and China and the United States at the Shangri-La Conference in May in Singapore (Interviews). One author was in Shanghai at the time of the conference and was able to observe and research media and public reactions.

UNITED STATES INTERESTS

Washington is working on an ambitious trade agreement with many Pacific nations, the Trans-Pacific Partnership (TPP), involving the U.S., Japan, and the ten countries of ASEAN. The 12-country group together would account for a third of global trade (*The Economist*, 2014, February 15). Missing the goal of finalizing the TPP in 2013, negotiations were due later in 2014.

The conception behind the treaty is to support and strengthen the forces of openness, rules and free trade. President Obama stressed the importance of the Pacific region to the United States. His plan to strengthen American leadership at the summit of the Asia-Pacific Economic Cooperation (APEC) was prevented by the government shutdown in Washington. China's Xi Jinping took advantage of the situation by pushing China's role in the foreground. This was another unfortunate episode that added to the doubts about America's will and resources to meet the challenge of a rising and potentially aggressive China (Crowley). Since then, the President's trip to the region and the U.S. presence at the Shangri-La Singapore Conference in May, 2014 helped to remedy the situation, and gave the U.S. the opportunity to respond to China's claim in the South China Sea (Interviews).

The Asia-Pacific region is the most important part of the world for the U.S. – it has two of the three largest economies: China and Japan, and is home to critical American treaty allies (Kaplan: Old World Order). The U.S. business sector considers Asia Pacific a vital region and wants to build stronger ties with the member nations of ASEAN through trade and investment. The ASEAN countries will become one unified entity when the ASEAN Economic Community (AEC) will create a single economic market by January 1, 2016 (Rothman). [For U.S.-ASEAN trade numbers consult tables in the Appendix].

The U.S.-ASEAN Business Council (USABC) is fostering U.S. business interests and advancing American corporations operating within ASEAN. The region is seen as of growing importance to the

economic health of the United States (Rothman), considering the huge market size and rising middle class. To U.S. business, the completion of the TPP is of vital interest, as is a greater development of two-way trade and investment between the U.S. and ASEAN governments and business sectors (Rothman).

Many Asian states want a stronger U.S. presence in the Pacific as a reassuring counterweight against Chinese assertiveness, especially over the claims to contested waters and territories (Crowley). Due to the Chinese stance of redrawing China's borders, even countries that once rejected American influence are now open to it (Crowley). The U.S. can provide vital stability through a strategic balance of powers. At present, China does not seem to be interested in a compromise. It looks as if the South China Sea will remain a source of anxiety in the region and a rivalry between China and the U.S. for years to come (*The Economist*, 2014, March 22).

JAPAN'S STRATEGY

After a clash over the ownership of some Japanese-controlled islands, Sino-Japanese relations remain cool, even though China is Japan's largest trading partner (Beech). Basically, the leaders of the world's second and third largest economies are not talking to each other.

Prime Minister Shinzo Abe, a foreign-policy hawk, wants to shore up relations with many of the nations in the Pacific (Einhorn & Philips). For that purpose, Abe is the first Japanese premier to visit all ten members of ASEAN. He also hosted the ASEAN leaders in December 2013 in an attempt to build a friendship network with nations around China (Einhorn & Philips; *The Economist*, 2014, January 4). ASEAN countries have always worried about China's role in the region and, although welcoming trade with China, always kept their trade options open with Europe, Japan, and the U.S. (Geib & Pfaff).

Abe is even pursuing areas within China's sphere of influence. He took his friendship campaign to Cambodia and Laos. Despite the Japanese pacifist tradition since the end of WWII, Japan is increasing military cooperation with Vietnam, Indonesia, and the Philippines, which have felt China's wrath over territorial claims (*The Economist*, 2014, January 25). According to Abe, he can envision a strategy where by Australia, India, Japan, and the U.S. state of Hawaii form a ring to safeguard the maritime commons from the Indian Ocean region to the Western Pacific (Einhorn & Philips).

Prime Minister Abe has taken advantage of every opportunity to strengthen relationships with Southeast Asian nations and to challenge some of the Chinese territorial claims. At the World Economic Forum in Davos, e.g., Mr. Abe criticized China's military build-up (*The Economist*, 2014, January 25). At the Shangri-La Singapore Conference in May, 2014, in his keynote address, Mr. Abe argued that Japan and the nations of Southeast Asia should play a stronger regional security role. In the process he announced that Japan would invest more in its military and security forces. The widespread perception was that Abe was advocating such measures in reaction to China's claims that a huge U-shaped swath of the South China Sea belongs to them (BBC; Interviews).

ASEAN: A LARGE TRADE GROUP

The geopolitical and economic organization ASEAN, the Association of Southeast Asian Nations, has become an essential trading bloc and market in the Southeast Pacific. Its 10-member nations – Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam – contain 620 million people, have a combined GDP of \$2.2 trillion and are seen as one of the most important global growth engines. The region features attractive economic and demographic trends, with a young and rapidly emerging middle class and strong domestic institutions (Rothman; Interviews). All of these countries have benefitted from many years of capitalist-style growth. The Association's trading ability will be further strengthened when the ASEAN Economic Community (AEC) will create a single economic market by January 1, 2016. This unified entity will allow for the free flow of goods, services and professionals within the member nations (Rothman).

China has been seeking closer ties with Southeast Asia and has used trade agreements to achieve its goals in the region. One of those agreements is the ASEAN-China Free Trade Area (ACFTA). Signed in 2002, to be implemented over a period of 10 years, is now fully operative. The agreement has benefitted both sides and mutual trade has expanded greatly. [See tables in Appendix]

Although beneficial to ASEAN, ACFTA has given China a tool to possibly disrupt trade flows with the trading bloc. The member nations of ASEAN operate by consensus and unanimity. If China can get only one country on its side, it can sabotage the group. As a result, the organization may not be able to stand up for its members such as the Philippines or Vietnam in their disputes with China (Kurlantzick, 2014).

China's latest proposal is the Regional Comprehensive Economic Partnership which will offer countries in the region greater access to the Chinese market without asking much of the partners in return (Zakaria). Most Asian countries will sign up for the partnership in order to expand trade into the Chinese market. China has become the chief trading partner for most countries in the region.

Still, they are willing to make painful concessions to sign up for America's vision for the region (Zakaria). Due to China's historic dominance of Southeast Asia, there is a heightened sensitivity in many countries to the possibility of "economic colonization" by China. Although China has achieved strong ties with certain members of ASEAN, many nations in the region, such as Malaysia, the Philippines, and Vietnam, still maintain a healthy fear of Chinese hegemony (Geib & Pfaff). There is certain ambivalence: on one hand the nations want to increase trade with China, on the other they wish to maintain alliances with the United States, Europe, and Japan (Geib & Pfaff).

In light of the recent claims by China in the South Pacific, tensions between ASEAN and China have risen. It seems that China is seeking to re-establish China's historic sphere of influence. The claim to the Spratly Islands, Paracel Islands, Macclesfield Bank, and Scarborough Shoal has resulted in protests from the affected countries. Especially Vietnam and the Philippines provoked the highest tensions (Interviews). China is incensed that the Philippines are challenging its ill-explained expansive claim in the South China Sea at the international tribunal of the United Nation's law of the sea (*The Economist*, 2013, October 19).

Actually, China's military buildup and more aggressive behavior has sparked an arms race, with Indonesia, Malaysia, the Philippines, Singapore, and Vietnam recently purchasing submarines, cruisers, fighter jets, and other arms. In view of the squabbles of who controls what island, almost all of these countries have been enlarging or modernizing their navies and air forces (Kaplan, *Old World Order*). As it is, they might welcome the overtures made by Japan. It also has become a fundamental reality that Southeast Asia looks to China as its main trading partner and America as the prime guarantor of its security (*The Economist*, 2013, October 19).

A Footnote on Vietnam

Because of its geography directly south of China, Vietnam has been trapped in its giant neighbor's sphere. Through history, China has invaded Vietnam seven times. Although Vietnam's identity has been established in opposition to China, Chinese contributions to Vietnam cover all aspects of culture, society, and government (Kaplan, *Asia's Cauldron*). Is it surprising that Vietnam is wary of any Chinese moves on its territory?

For exactly those reasons, the most serious recent maritime conflicts have occurred between China and Vietnam. The two countries have periodically clashed over the Paracels and the Spratlys. There have been multiple clashes between ships and personnel. This has led to anti-China protests in the streets of Hanoi and Ho Chi Minh City. The most serious recent anti-Chinese demonstrations occurred in May of 2014. At that time the Chinese moved a drilling rig into waters near the Paracel Islands leading again to multiple collisions between Vietnamese and Chinese ships (Interviews). The anti-Chinese sentiment turned violent. Chinese business people were killed and Chinese businesses were looted and burned. The Chinese government conducted a massive evacuation of Chinese citizens by sea and air (Interviews).

CONCLUSION

The discussion above has centered on the relationship between the major players in the Pacific. Long-standing trade agreements in the region are revisited and new trade arrangements forged to reflect present-day conditions. China, for instance, has sought closer trade ties with the members of ASEAN for the past ten years in order to secure access to raw materials and intermediate goods, but also to find new markets for its exports. The ASEAN-China Free Trade Area is a reflection of that. Recently, Beijing has

put forward a new partnership, the Regional Comprehensive Economic Partnership, to offer Southeast Asian nations greater access to the Chinese market.

The United States has been a leading member in the Asia-Pacific Economic Cooperation Forum (APEC), but Washington is now working on an ambitious trade agreement with many Pacific nations, the Trans-Pacific Partnership (TPP), involving the U.S., Japan, and the ten countries of ASEAN. It is a reflection of Washington's policy shift toward the Asia-Pacific region and the building of stronger ties with the Pacific countries.

Although the members of ASEAN welcome the trade arrangements with China which will give them greater access to the Chinese market, recent maritime claims by China in the South Pacific have led to rising tensions between ASEAN and China. Several of the ASEAN countries, especially Vietnam and the Philippines, have had serious disputes with China over contested areas in the South China Sea. Due to China's historic dominance of Southeast Asia, there is a healthy fear of Chinese hegemony that translates into maintaining alliances with the United States, Europe, and Japan.

The Chinese claims on a group of islands controlled by Japan have dampened the relations between the two countries, even though China is Japan's largest trading partner. The events in the Pacific had the effect that Japan is re-examining its military goals. But it also led to Japan's efforts to form closer ties with Southeast Asian nations. Prime Minister Abe's visit to all members of ASEAN is proof of that. His aim to build a friendship network with nations around China clearly shows Japan's intentions of closer integration.

The maritime disputes with China took center stage at the Shangri-La Singapore Conference in May, 2014 and led to clashes between China, Japan, and the United States. The trade implications of these maritime disputes are profound. Fifty percent of global oil tanker shipments pass through the South China Sea. This is three times more tanker traffic than in the Suez Canal. It is five times the traffic that passes through the Panama Canal (Council of Foreign Relations). Other startling facts: at least half of the world's top ten shipping ports are located in the region of the South China Sea (Council on Foreign Relations).

Freedom of the seas is important to all nations in the region. It is clear from the discussions at the Shangri-La Singapore Conference that the United States and Japan demand freedom of the seas (BBC). Despite China's assertiveness in the Pacific there is a compelling argument that China is as interested in maritime freedom as any country involved in the disputes (Council on Foreign Relations). Although China has been stressing regional trade, the country remains tied to the United States and the European Union through trade and investment. The expansion of China's foreign direct investment all over the world can only flourish with an open trade policy and freedom of the seas.

**TABLE 1
CHINESE AND U.S. TRADE WITH ASEAN**

	1997	2005	2006	2005-2006 % Change	1997-2006 % Change
China's Exports to ASEAN (\$ millions)	12,698	55,459	71,325	28.6	450.0
U.S. Exports to ASEAN (\$ millions)	48,271	49,637	57,307	15.5	18.7
China's Exports to ASEAN as a Percent of Total Exports (%)	7.0	7.3	7.4	-	-
U.S. Exports to ASEAN as a Percent of Total Exports (%)	7.0	5.5	5.5	-	-
China's Imports from ASEAN (\$ millions)	12,357	75,017	89,538	19.4	624.6
U.S. Imports from ASEAN (\$ millions)	71,013	98,915	111,201	12.4	56.6
China's Imports from ASEAN as a Percent of Total (%)	9.0	11.4	11.3	-	-
U.S. Imports from ASEAN as a Percent of Total (%)	8.2	5.9	6.0	-	-

**TABLE 2
ASEAN TRADE WITH THE UNITED STATES AND CHINA FOR 1995, 2000, AND 2006
AS A PERCENT OF TOTAL TRADE**

ASEAN Imports (% of total)			
	1995	2000	2006
United States	14.6	14.0	10.3
China	2.2	5.2	11.4
ASEAN Exports (% of total)			
	1995	2000	2006
United States	18.5	18.0	13.9
China	2.1	3.5	8.9

Sources: ASEAN Secretariat, *2005 and 2006 ASEAN Yearbook* and International Monetary Fund, *Direction of Trade Statistics*, June 2007.

Notes: Data for 2006 do not include Laos and Myanmar (Burma); ASEAN trade data differ from that reported by its trading partners.

Sample Questions for the Interviews:

1. What are the most important countries and why in the ongoing evaluation of the legal treaty, and economic development in the region?
2. What is your view of prevailing changes in organizational and corporate culture in the ongoing evolution of the region?

3. What has been the evolution of trade patterns in the region and the relationship to China?
4. What is your assessment of the impact of Chinese economic development on your country?
5. What is your assessment of macroeconomic development in your country in the last ten years?
6. What is the impact of Chinese political influence on economic development in the region?
7. What has been the impact of the financial crisis on your development?
8. What has been the influence of the financial crisis on China's economic development and how might this relate to regional relations?
9. What has been the evolution of the trade treaty with China and related treaty developments?
10. What is the significance of outward and inward direct investment on relations among ASEAN countries?
11. What is the influence of outward and inward foreign direct investment on relations among ASEAN countries?
12. What is your perception of the threats and opportunities to your business presented by the evolving legal framework given the problems of corruption and lack of transparency?
13. How has regional legal and political development changed your business?
14. What is the future of trade patterns and further treaty-related developments?

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