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Is China really a threat to maritime trade?

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Western media commonly claims that more than US$5 trillion in trade passes through the South China Sea annually. This figure appears to originate from a 2011 press release by US Navy admiral Robert F. Willard, who cited the value of trade flows as a reason why the sea lanes were 'incredibly vital' to the United States and the region as a whole.

Similarly, the Australian government's 2016 Defence White Paper says that Australia's interests in the region stem in part from nearly two-thirds of its exports traversing the South China Sea, including iron ore, coal and liquefied natural gas destined for major customers in Northeast Asia.

Many commentators argue that China's assertiveness in the South China Sea potentially puts this trade at risk.

Given that nearly every country in the region is more dependent upon trade than the United States, it might be expected that more frequent US freedom of navigation patrols (FONOPs) to challenge China's 'excessive claims' in the South China Sea would receive broad backing.

But to date the regional response to China's actions has been limited. There were four US FONOPS between October 2015 and November 2016. Meanwhile, security allies such as Australia have hosted a steady procession of US navy admirals hinting that they too should run their own FONOPs. Yet no US friend, partner or ally in the region has taken up the suggestion so far, at least on penetrating the 12 nautical mile zone around Chinese claimed territory.

One compelling explanation for the muted response is that the incentives countries have to take more dramatic action are weaker than often put.

First, the US$5 trillion trade figure looks inflated. Comparing it with WTO numbers for the total value of world trade and the proportion of trade value that is transported by ship would necessitate that around 43 per cent of world seaborne trade value passes through the South China Sea. Yet a report by PwC in 2011 listed the world's top 25 bilateral trade relationships and many go nowhere near the waterway, instead crossing the Pacific and Atlantic oceans.

Second, of the trade that does go through the South China Sea, the bulk is to and from China. China has no interest in blocking this because every dollar stems from a good that China wants to buy or sell.

In particular, China has become highly dependent upon seaborne imports to meet its demand for energy, as well as basic industrial inputs such as iron ore. A wide variety of Chinese experts worry that in the event of a crisis the United States could sever these supplies at will. This suggests that to the extent that freedom of navigation has figured in China's island building calculations in the South China Sea, the more rational explanation is that it is motivated by a desire to protect it, rather than undermine it.

Third, the risk of other countries' trade being halted or subject to a costly diversion is exaggerated.

There is a history of countries finding ways to divert their trade when necessary. When the Suez Canal was closed during 1967–1975, the increase in shipping distances suffered by most Asian countries was modest, despite the route's importance connecting the region with Europe.

Econometric evidence finds that the relationship between shipping distances, trade flows and national income is statistically significant but diffuse, implying that even if China were able to block the South China Sea, the impact on economic growth in other countries is likely to be small.

Shipping density maps show that Vietnam, Indonesia, Taiwan and the Philippines are largely served by merchant vessels that take coast hugging routes outside China's nine dash line.

And trade with China aside, the only Australian exports that go through the South China Sea are with Thailand, Vietnam and perhaps Taiwan. This equates to just 5.5 per cent of Australia's total goods exports, compared with 30.9 per cent to China.

The busy trade route between eastern Australia and Japan and South Korea travels east of the Philippines. Even iron ore from Western Australia destined for Northeast Asia passes through the Lombok Strait, avoiding the South China Sea.

It was recently claimed that the country most at risk from China controlling the South China Sea was Japan, which was 'utterly dependent' on the waters for vital energy supplies. But a 2013 Japanese study found that exclusively taking the Lombok route would have increased Japan's oil import costs by $US300 million annually. This equates to just 0.2 per cent of Japan's oil import bill that year. The ease with which oil supplies could be rerouted away from the Strait of Malacca to the Sunda, Lombok or other passages has also been confirmed by scholars at the US Naval War College.

Rather than preserving commercial freedom of navigation, Australia's first ambassador to China, Stephen FitzGerald said last month that 'what the US is really about is freedom of navigation for its military ships and aircraft to push hard up against Chinese waters — which it would not countenance near its own waters'.

The United States is of the view that the freedom of navigation specified in the UN Convention on the Law of the Sea (UNCLOS) applies to both commercial and military vessels. The majority of the 167 UNCLOS signatory states share this view. But there is a significant minority of more than 60 coastal states that in practice take a contrary stance by asserting some type of security rights within their exclusive economic zones. They include Bangladesh, India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines, Thailand, Vietnam and South Korea. And of course, the United States is not an UNCLOS signatory at all.

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