

# An Asia trade war threatens

The trade war between the USA and China is ongoing. Abhijit Mukhopadhyay says the Japan-South Korea dispute threatens to further derail international business

## The background

The full-blown trade war between the USA and China is yet to be resolved substantially, despite repeated negotiations. Meanwhile, in one corner of the Asian continent another unexpected trade war has triggered prospects of further deterioration in international trade.

In early July this year Japan has decided to tighten restrictions on the export of semiconductors and computer displays used in smartphones and chips to South Korea, effective from 4 July 2019<sup>1</sup>. Though the decision may look like a unilateral one, but there is a deeper and longer history behind.

This was triggered by the late 2018 Korea's Supreme Court verdict which ruled against several Japanese companies including two of Japan's largest – Mitsubishi Heavy Industries Ltd and Nippon Steel & Sumitomo Metal Corporation<sup>2</sup>. The verdict was in favour of the families of the South Koreans who were illegally forced to work for Japanese companies during the Second World War.

Many of these 'conscripted' workers worked as bonded labours or slaves without pay in different facilities in Japan, including a Mitsubishi shipyard and machine tool factory in Nagoya in 1944. Mostly members of these workers' families are the complainants against Japanese companies in Korean courts.

While Mitsubishi has been ordered to pay \$134,000 to each of ten claimants in the case, Nippon Steel & Sumitomo Metal Corporation has been asked to pay \$88,000 to each of four plaintiffs. Subsequently, a South Korean Court ordered the seizure of shares worth \$356,000 held by Nippon Steel in a joint venture with South Korean steel company Posco. Japanese government promptly called this move unlawful and made all efforts to block its implementation<sup>3</sup>.

This is not all; more than 12 such cases are pending in various South Korean Courts involving around 70 Japanese companies – as claimed by the Ministry of Foreign Affairs of Japan. A Stanford University Research paper puts the number of Korean workers in colonial period sent to mainland Japan, Sakhalin and the Southern Pacific islands for working in the mining, construction and shipbuilding industries at an estimated 725,000. Most of these workers are no more, but their family members have sought legal avenues to sue Japanese companies<sup>4</sup>.

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## The timeline

After Japan's decision to restrict exports of semiconductors and computer displays, the government of South Korea make their displeasure known and regretted the 'economic retaliation' of a verdict made by the courts in the country, on which the government does not have any control. Japan denied retaliating in response to the court verdict, and cited 'weaknesses' in South Korea's export control system.

Absence of talks between trade authorities, lack of trust and security risks were cited as the reasons behind the decision<sup>5</sup>. However, no specific example of such 'weaknesses' or 'security breach' have not been mentioned officially.

It seems that current unilateralism and protectionism have a popular justification in 'security risks'. This was started by the USA last year, but increasingly followed by other countries to impose trade restrictions.

South Korea, of course, denied these accusations and stated that an emergency inspection of companies importing chemicals from Japan showed no evidence that these chemicals were subsequently sent to any other countries, including North Korea<sup>6</sup>.

Japan followed their export restriction decision with removal of South Korea from a white list of countries with preferential trade status. So, Japanese companies exports to South Korea now have to be approved on a case-by-case basis for three materials used in semiconductors, smartphones and other high-tech devices. Incidentally, these final products are South Korea's key exports to the world<sup>7</sup>.

This led to a panic and frenzy among the electronics and smartphone manufacturers in Korea for obvious reasons. Samsung Electronics Vice Chairman went to Japan in July to secure his company's value chain, in the light of the Japanese export restrictions<sup>8</sup>.

In August, Japan approved export of a material, known as EUV photoresists, to South Korea – with a warning that any ‘improper use’ would compel Japanese government to expand the restrictions on export to other products. Photoresists is crucial for Samsung’s advanced contract chipmaking production<sup>9</sup>.

On 12 August Korean Industry Ministry announced that Korea would drop Japan as a ‘preferred trading partner’. Subsequently, the government made the necessary administrative steps and dropped Japan from the country’s preferred list of trade partners in September. Japan has been relegated to the A-2 group countries, where strategic goods can be exported under certain conditions. The government also assured the Korean exporting companies that it will minimise their losses<sup>10</sup>.

Meanwhile, in September South Korea’s Trade Minister conveyed the country’s decision to file a complaint to World Trade Organization (WTO) against Japan. The minister has termed Japan’s export restrictions ‘politically motivated’ and ‘discriminatory’<sup>11</sup>.

Later in the month, foreign ministers of these two countries met on the sidelines of the United Nations General Assembly. Though the meeting has been claimed to be ‘cordial’, South Korean Foreign Minister conveyed that “*big disagreements on the issues at hand*” remain<sup>12</sup>.

Immediately after that, on 1 October the South Korean Trade, Industry and Energy Ministry issued a statement saying that the Government of Japan has not approved shipment of hydrogen fluoride to Korea even after 90 days of submission of a Japanese exporter<sup>13</sup>.

On 11 October, two countries ended their first round of discussions on the dispute with an agreement to meet again for further consultations. The meeting has taken place in the context of Korea’s complaint with WTO<sup>14</sup>.

This is apparently part of WTO dispute settlement procedure and if the issue does not get resolved within 60 days then South Korea can request the WTO Dispute Settlement Body to establish a panel to deliver a verdict. Another round of talks has been held on 19 November, but the deadlock remained<sup>15</sup>.

These two Asian economic powerhouses are once again slated to meet in third week of December for senior level talks amidst some hope of de-escalation. All eyes will be on this series of meetings in the year-end<sup>16</sup>.

### **The history**

Japan colonised the entire Korean Peninsula from 1910 till 1945. But the legacy of that colonial past still haunts both these nations, as can be observed in current trade war between these two. Apart from the conscripted labour in mining, construction and shipbuilding industries during the period around Second World War, the issue of 'comfort women' is another big and sharp thorn of the Japanese colonial past.

Different historians estimate the number of affected women at anywhere between 50,000 to 200,000. These women, many of them Korean, were forced into service in Japan's military brothels during Second World War. Enlisted to the military 'comfort stations' by force, Korean 'comfort women' – many of them under the age of 18 – were exploited as sex slaves in those confinements.

After South Korea unshackled itself from the clutches of Japanese colonialism demand and negotiations for compensation started with Japan. In 1965, an agreement was inked whereby Japan provided \$800 million (\$6.5 billion in 2019 dollars) aid to South Korea as 'economic cooperation'.

However, the issue of 'comfort women' refused to die down. In 2015, both the countries reached a 'final and irreversible' agreement that arrived with a personal apology to the affected women from Japanese Prime Minister

Shinzō Abe and around \$8 million for a compensation fund. But a substantial part of South Korean population rejected the deal as they felt it was done without consulting the victims or their families.

Some of them refused the compensation money in protest. President Moon Jae-in discarded the 2015 agreement and shut down the foundation for comfort women, funded by Japan, in November 2018 – around a month before the contentious Supreme Court verdict<sup>17</sup>.

There have been immediate repercussions in both the countries against the other one. For example, beer exports from Japan to South Korea fell almost 100% in the month of September 2019<sup>18</sup>. The outlets of Japanese retail chains like Muji and Uniqlo have been practically boycotted by the South Koreans in Seoul and other Korean cities before the year-end festive season.

Similarly, in Japan there has been a revival of old tropes about 'untrustworthy' Koreans. Since the normalisation of ties since 1960s these two countries have mostly been able to keep their cultural, political and social disagreements separated from the realms of commerce and national security<sup>19</sup>. However, this time the emotions are running high, and history and politics seem to trump business and economics.

## **Conclusion**

What the US President Donald Trump started last year is now spreading like a virus all over the world now. The model of unilaterally imposing various restrictions on trade and economic partners has gained legitimacy since the world's largest economy is doing that repeatedly. Additionally, the USA under Trump has practically relinquished the mantle of global leadership. Both Japan and South Korea are close allies of the USA; ideally the USA should have persuaded these two countries away from precipitating this crisis. But in a new world economic and political order that is not going to happen.

Exports of chemicals, which Japan restricted for South Korea, are pivotal for the global tech industry. Japan accounts for as much as 90% of global production of these chemicals. The country exported \$400 million worth of these products to South Korea in 2018. Value-wise it may not look that substantial, but these inputs are essential for all kinds of electronic devices.

South Korea, moreover, is a dominant manufacturer of memory chips. If Japan chokes the supply line to South Korea then there will be a cascading effect through global supply chains<sup>20</sup>. With the US restrictions on Chinese giants like Huawei and ZTE existing, this may sound like huge trouble for the manufacturing of all kind of tech products across the world.

Needless to say, apart from this technological halt or pause, this may even result into increase in the prices of tech products. The inequality in ownership of tech gadgets and products across different segments of consumers may also get hastened subsequently.

Ironically, in 2011 China restricted exports of rare-earth minerals to Japan, and then Japan responded by investing in its own mines – resulting in drops in Chinese market share in rare-earth minerals. If South Korea enhances its capabilities to produce these key chemicals on their own in the long run, then even Japan will face similar eventualities.

Regional supply chains in this part of Asia, in any case, is thoroughly disturbed now – as South Korean and Japanese companies are rushing in the chaos to find alternatives to China as a manufacturing base, in the light of American sanctions.

President Trump has already cautioned both these countries with a threat to impose import duties on their cars. So, what Japan is doing may harm its economy more than any other.

However, this muddle has not yet reached the stage where de-escalation is not possible. These are still early days, and commercial damage till now has been limited. One can still be optimistic about a defused situation.

But, the outcome of this conflict is a litmus test for global trade – it will decide if the global trading system can still resolve disputes amicably or the new meaner order, in which supply chains are weaponised in political games, is here to stay for some time. ■

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#### *Endnotes*

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