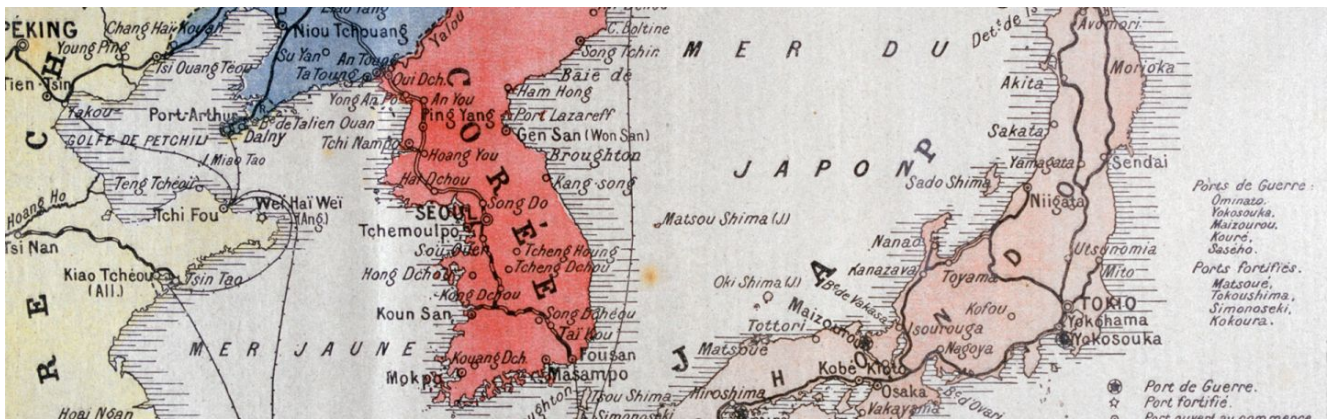


Seoul and Tokyo Stare Each Other Down

- *Japan's move to impose unprecedented trade measures against South Korea to retaliate against its increasingly hard-line stance toward Tokyo's wartime conduct will leave Seoul with few options to respond effectively.*
- *Domestic political drivers in both South Korea and Japan will make it difficult for the two sides to reach a compromise on their outstanding wartime tensions.*
- *Both the United States and China will push the pair to de-escalate their impasse.*



Economic progress might alleviate historical trauma, but it's unlikely to solve it. Today, South Korea and Japan are vibrant democracies that enjoy robust economies and protection under the U.S. military umbrella, yet Japan's wartime actions continue to cast a long shadow over its relations with its neighbors in Northeast Asia. South Korea's 35 years under Japanese rule, status as a fellow U.S. ally and vulnerable geopolitical position between Japan and China ensure that Japan's imperial legacy is particularly contentious on the peninsula.

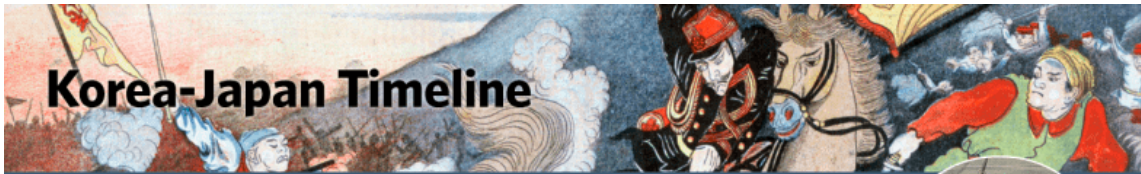
This painful history has been front and center since the 2017 election of President Moon Jae In, who has taken a more confrontational stance on historical issues. Indeed, ties between the countries have become much frostier in the past two years — to the extent that Tokyo has even launched a Trump-style trade war in recent weeks. Given the deep connections between their economies and Japan's

longtime trade surplus, Tokyo has numerous ways of exacting pain on South Korea's already-beleaguered industry. Meanwhile, South Korea's vociferous domestic politics will make it difficult for Moon to easily reach a compromise with Japan. And while neither the United States nor China wants the standoff to spiral out of control, there is no immediate solution on the horizon, meaning the dispute will continue to cause headaches for South Korea — as well as the customers for its industrial goods.

A Troubled Past

Korea was an integral part of the Japanese empire from Tokyo's annexation in 1910 until the Allies liberated it in 1945. The rapid onset of the Cold War, however, thrust South Korea into an awkward alignment with its former aggressor as the United States refashioned a now-pacifist Japan into the keystone of its Pacific strategy.

Korea-Japan Timeline



1st Sino-Japan War, 1894-95
Korea enters Japan's sphere of influence

August 1910: Japan annexes Korea with the Japan-Korea Treaty, making it a Japanese colony.

1932-1945: Japanese authorities force women from Korea, Japan, China and Southeast Asia to become "comfort women" as part of a system of forced military prostitution.



1944-1945: Japan expands its National Mobilization Law to forcibly recruit hundreds of thousands of individual Koreans for labor in Korea, Manchuria and Japan.

June 1965: South Korea and Japan sign a Treaty on Basic Relations to establish diplomatic ties. As a result of the pact, Japan sends South Korea loans and aid as a form of wartime compensation.

1986 to 1993: Beginning with political unrest and constitutional reform, South Korea slowly abandons authoritarianism, culminating in the first freely elected president since the 1950s.

September 2013: South Korea fully bans Japanese seafood imports from eight prefectures near the Fukushima nuclear power plant out of concern over the effects of the 2011 meltdown.

May 2017: Progressive South Korean President Moon Jae In assumes office after pledging to renegotiate the 2015 deal.

December 2017: A South Korean government panel set up to reexamine the 2015 comfort women deal issues a report condemning it.

April 2019: The World Trade Organization upholds South Korea's ban on Japanese seafood from areas near the Fukushima meltdown, overturning a 2018 lower court ruling.

July 2019: South Korea officially closes the comfort women compensation nonprofit.

November 1905: Korea becomes a protectorate of Japan following the Russo-Japanese War. Two years later, Japan takes direct control of internal affairs.



1938: Imperial Japan's National Mobilization Law expands the use of forced and coerced labor throughout the empire.

August 1945: Imperial Japan surrenders, as U.S. and Soviet troops occupy the Korean Peninsula.

October 1951 to June 1965: Seoul and Tokyo conduct seven rounds of talks to normalize relations.

April 1952: Korean governments are barred from signing the Treaty of San Francisco, which sets peace terms — including reparations for wartime actions — between the Allies and Japan.

August 2011: South Korea's Constitutional Court rebukes the South Korean government for inaction on addressing Japan's wartime conduct toward comfort women.

May 2012: South Korea's Supreme Court issues a ruling allowing for wartime forced laborers to make claims against Japanese companies.



December 2015: South Korea and Japan sign a deal for \$8.3 million in compensation for comfort women and an apology, appearing to pave the way to final resolution of the issue.

November 2018: South Korea decides to shut down the non-profit tasked with dispensing Japanese compensation to comfort women under the 2015 deal.

November 2018 to June 2019: A series of South Korean court rulings awards compensation to laborers from Japanese companies.

2019

But through the decades, the question of Japan's wartime conduct and its legacy have remained. A now-controversial 1965 treaty normalized bilateral relations and earned South Korea the equivalent of \$2.4 billion in Japanese loans, aid, and property claims, yet the country's grievances are deeply rooted. They bubbled up again after South Korea transitioned fully in 1993 from authoritarian rule to a civilian government responsive to grassroots grievances toward Japan.

Since then, relations with Japan have oscillated depending on who is in charge in Seoul, with progressives adopting a more confrontational stance and conservatives de-escalating tensions in the interest of cooperation. Previous conservative South Korean President Park Geun Hye fostered cautious rapprochement with Japan out of a desire to counterbalance China's rise, forging a landmark \$9.27 billion deal in 2015 meant to settle the issue of "comfort women" who were victimized by Japan's wartime system of sexual slavery. The progressive Moon, by contrast, has made renegotiating that 2015 deal a banner issue for his presidency, steadily butting heads with Japan. Above all of this, the regional landscape has changed dramatically in the past decade due to China's emerging economic importance and increasing U.S. efforts to counter its rise. As South Korea and Japan's key respective economic and defense partners, neither of these Pacific titans want to see Tokyo-Seoul ties deteriorate.

Moon Rises

Moon has presided over the gradual downturn in ties with Japan. Seeking better compensation terms, Moon has steadily undone Park's 2015 deal for Japanese compensation to comfort women, finally shuttering the South Korean group responsible for administering the funds on July 5. And while Moon and Japanese Prime Minister Shinzo Abe did agree to extend a key intelligence-sharing pact minted under Park on August 2017, he only did so due to sky-high North Korea tensions. Since then, leaks suggest South Korea has restricted the scope of such sharing to North Korean missiles, rather than broader cooperation.

There have been bright spots, most notably a trilateral China-Japan-South Korea summit in May 2018 — the first in three years — to discuss a long-awaited trade deal. However, the chances of such a summit occurring this year are extremely low. At the Group of 20 summit in Osaka in June, Abe and Moon failed to meet. And this deterioration has bled into the military sphere. Japan claimed that a

South Korean destroyer locked its fire-control radar onto a P-1 patrol plane in Japan's exclusive economic zone in December 2018, while South Korea alleged that a Japanese P-3C flew dangerously close to a South Korean destroyer in the East China Sea in January. Then, in April, South Korea won a World Trade Organization case against Japan that allowed it to maintain blanket bans from 2013 on Japanese seafood from areas around the site of the Fukushima Daiichi nuclear disaster, riling Japan further.

Japan has carefully calibrated the measures to hit major South Korean industries at a, particularly inopportune time.

Waking the Sleeping Giant

These increasingly fraught relations have come to a head in recent weeks as South Korean courts have ordered Tokyo to compensate wartime-era laborers forced into service by the Japanese imperial government. Building on a 2012 South Korean Supreme Court ruling, local courts ordered Japanese companies Nippon Steel, Mitsubishi Heavy Industries and Nachi-Fujikoshi Corp. to pay compensation ranging from \$70,000 to \$90,000 to each of around two dozen South Korean wartime laborers or their surviving relatives. Although the figures are individually small, they worry Japan since estimates suggest upward of 700,000 Koreans were forced to work for Japanese companies and because South Korean courts have threatened to freeze the local assets of Japanese companies if they refuse to pay. Already, South Korean plaintiffs are preparing to file a case to seize the assets and auction them off to meet their claims.

In response to the compensation rulings, Japan has called for the two countries to establish an arbitration board as specified in Article 3 of their 1965 renormalization pact, vowing to take the issue to the International Court of Justice if South Korea declines. Tokyo wants Moon to soften his combative stance toward Japan, potentially by adopting a compromise approach to laborer compensation that could involve some sort of joint fund that would end the flurry of cases against Japanese entities.

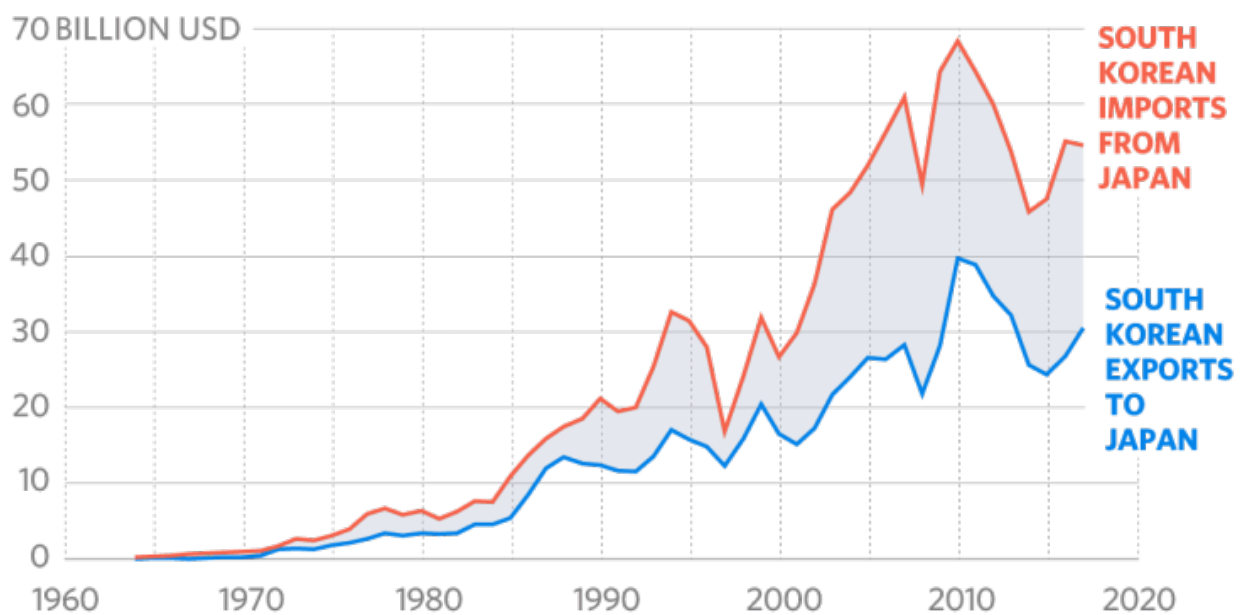
Seoul, however, failed to take Tokyo up on its offer, prompting Japan to unveil unprecedented trade countermeasures against its neighbor on July 1. Citing eroding bilateral trust — while denying any links to the recent court cases —

Japan removed three very specific chemicals critical to South Korea's semiconductor and smartphone industries from an expedited export list. As a result, fluorinated polyimide, photoresists and hydrogen fluoride are now subject to delays of up to three months on both delivery and technology transfer.

Taking a Calculated Move

Japan, which has a \$24 billion trade surplus with South Korea, has carefully calibrated the measures to hit major South Korean industries at a, particularly inopportune time. In June, South Korea reported a 13.5 percent year-on-year drop in its exports — the largest since 2016 and a figure that even trailed a 9.4 percent drop in May. Semiconductor exports are also plumbing the depths — dropping 25.5 percent year-on-year in June to mark a seventh straight month of decline amid weak global demand and the U.S.-China trade war. On July 2, South Korea's Finance Ministry slashed its 2019 growth projections to between 2.4 and 2.5 percent, down 0.2 percent from initial forecasts and the lowest since 2012. At such a time, South Korea is hardly in a place to restrict imports from Japan, which is a particularly large source of machinery, plastics, electronics and chemicals that are all crucial to South Korea's industrial production.

South Korea-Japan Trade Imbalance



Source: KITA

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For Moon, Japan's aggressive move comes amid weakening approval ratings, which could complicate the remainder of his tenure as president if his allies perform poorly in parliamentary elections in April 2020. According to May opinion polls, Moon had just a 45 percent approval rating (and only 30 percent for his handling of the economy and employment) — a major drop from the 83 percent rating he enjoyed a year before. It doesn't help that Moon's progressive economic policies are blamed for compounding economic issues, as a 29 percent minimum wage hike and limits to working hours have driven up corporate operating costs. And given that his stagnating overtures to North Korea provide little hope of a popularity boost, Moon will now need to weigh his popular nationalist stance toward Japan against the country's deepening economic woes. Although Moon has hinted at countermeasures, pressure from the country's all-important Chaebol conglomerates — who stand to lose much from Japanese retaliation — may be decisive.

Even worse for South Korea, the other shoe has yet to drop. Japan may next move to kick its trade war into high gear by removing South Korea from a 27-country "white list" at a hearing due July 24. Doing so would result in the imposition of an onerous national security vetting process on an untold number of South Korean purchases from Japan (the only exceptions would be food and timber) to assess whether Seoul will use them in either conventional weapons or weapons of mass destruction. In such a situation, tech transfers would fall under scrutiny as well. The measures could damage South Korea's machine tools and advanced materials imports, as well as electronics, which represent 15 percent of Japan's exports to South Korea and nearly 10 percent of South Korea's total electronics imports. In justifying its moves, Tokyo has argued through both official and unofficial channels that South Korea's export controls are weak, implying that Seoul has failed to halt the smuggling of dangerous goods to sanctioned countries such as North Korea and Iran.

The Fallout

Steeling themselves for the ramifications, South Korean companies have said they possess a few months of stockpiles and that lower semiconductor demand will ease some of the production pressure. At the same time, Seoul's municipal government has promised money to assist with shortfalls, while the central

government is seeking budgetary requisitions to kick-start the indigenous production of the restricted chemicals. Moreover, South Korea has also appealed to the World Trade Organization.

Even so, Japan's restrictions threaten crucial South Korean sectors that rely on Japan for the key chemicals. Between January and May, Japan accounted for 44 percent of South Korea's hydrogen fluoride imports, 92 percent of photoresists imports and 94 percent of fluorinated polyimide imports, according to the Korea International Trade Association. South Korean manufacturers will need to scramble to replace these chemicals with supplies from elsewhere or face delays due to scrutiny that could hamstring operations. Naturally, the country could even face deeper repercussions if Tokyo removes Seoul from its export white list.

In terms of specific items, South Korea's dynamic random-access memory (DRAM) exports, 3D NAND flash memory, organic light-emitting diode (OLED) and liquid crystal displays (LCD) could all bear the brunt of Japan's anger. In 2018, South Korean semiconductors made up 24 percent of the global market share, behind only the United States at 45 percent. For South Korea, such exports are vital. Integrated circuits, which are produced using semiconductors, accounted for over 18 percent of total South Korean exports — the largest of any product category. Taken together with semiconductors themselves and smartphones, the Japanese chemical input restrictions could impact around 20 percent of South Korea's total exports.

With 2020 elections approaching, South Korea's president may choose to double down on his confrontational approach to Japan, which could provide a convenient scapegoat for the country's economic woes.

Top South Korean chipmakers could avoid some of the consequences by shifting production to China, but smartphone manufacturers who mostly make their displays in South Korea would need to make major adjustments to shift their production across the Yellow Sea. Moreover, offloading some chipmaking to their facilities in China carries its own risks given the still-burning U.S.-China trade war, as large South Korean companies in China are already working to shift some of their capacity to places like Vietnam. And then there's the lingering problem of Seoul's own relations with Beijing: In 2017, China instituted a tourist boycott and other economic measures on South Korea after the latter deployed the U.S. Terminal High Altitude Area Defense (THAAD) system. Today, ties between

Beijing and Seoul are on the mend, yet they remain tenuous.

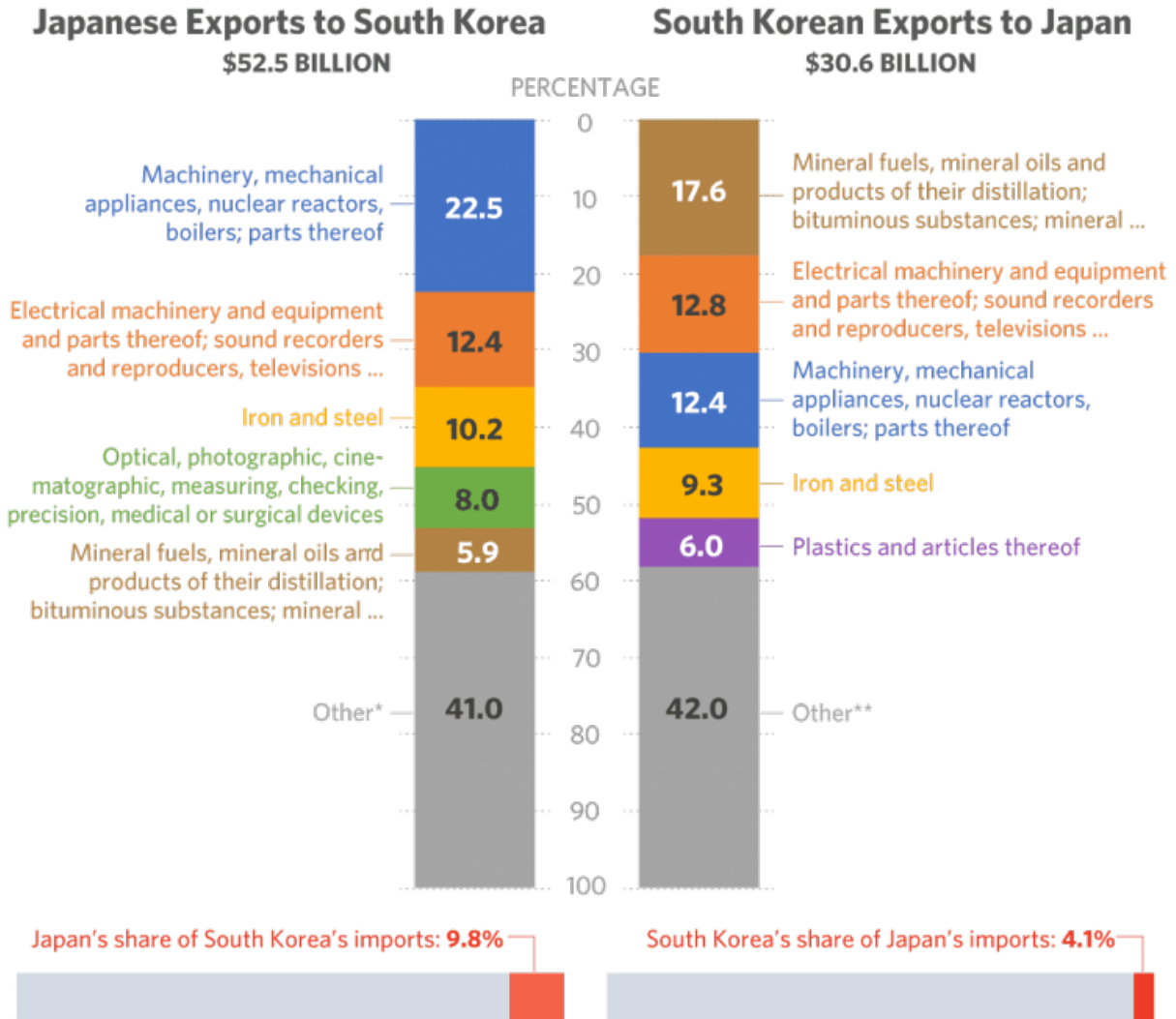
South Korea has other options as well, although they hardly present an easy solution. First and foremost, South Korean companies could simply request that Japanese manufacturers ship the necessary chemicals from their overseas factories, but this might prove difficult given the political pressure on corporations. Russia has reportedly offered to step in with some hydrogen fluoride supplies, but shifting import sources would be challenging given the need to implement new testing and quality-control regimens to ensure the new sources fit industrial standards. Ultimately, the saving grace for South Korean companies in the near term may be the very slowdown in global semiconductor demand that has hurt the country in recent months — meaning lower production will be tolerable due to the global glut in chips. With several months of stockpiles on hand, South Korea might thus not feel the true cost of the trade war for some time.

A Measure With Staying Power?

Amid the debate, domestic Japanese factors could have a bearing on the future of Tokyo's measures. On July 21, Japan's ruling Liberal Democratic Party will go into upper-house elections with the hopes of grabbing the two-thirds majority needed to effect long-awaited constitutional reform, and recent polls indicate that the moves against South Korea are highly popular, with 58 percent expressing support versus just 24 percent who are opposed. But even if the hard line is an example of electoral posturing, Japan is unlikely to climb down even after the ballots are counted. South Korea, for one, has unilaterally pushed Japan since 2017, and Tokyo is now showing it will only back down if Seoul compromises. For Japan, too, the measures do not affect the economy much beyond the relevant chemical manufacturers — for whom product lines in question are not particularly critical. Given that the chemical export restrictions and potential move to strike South Korea from the white list represent only increased scrutiny from Japanese authorities — rather than a total export ban — Tokyo will have wide discretion to shape them in a way to maximize the damage to Seoul and minimize it for Japanese companies, meaning Japan has little reason to abandon its position of strength.

South Korea-Japan Trade Snapshot

While South Korean and Japanese economies are deeply intertwined, the former is far more reliant on imports from Japan — particularly higher-value manufactured goods and electronics.



* Category includes: Plastics and articles thereof; Organic chemicals; Commodities not elsewhere specified; Miscellaneous chemical products; Vehicles other than railway or tramway rolling stock, and parts and accessories thereof; Inorganic chemicals and organic or inorganic compounds of precious metals, of rare-earth metals, ...; Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring ...; Articles of iron or steel; Photographic or cinematographic goods; Essential oils and resinoids; perfumery, cosmetic or toilet preparations; Copper and articles thereof; Glass and glassware; and Other items.

** Category includes: Organic chemicals; Articles of iron or steel; Natural or cultured pearls, precious or semi-precious stones, precious metals, metals cladding ...; Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, ...; Vehicles other than railway or tramway rolling stock, and parts and accessories thereof; Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical devices...; Fish and crustaceans, molluscs and other aquatic invertebrates; Essential oils and resinoids; Perfumery, cosmetic or toilet preparations; Aluminium and articles thereof; Tobacco and manufactured tobacco substitutes; Miscellaneous chemical products; Copper and articles thereof; Aircraft, spacecraft, and parts thereof; Articles of apparel and clothing accessories, knitted or crocheted; Rubber and articles thereof; Tools, implements, cutlery, spoons and forks, of base metal; Parts thereof of base metal; and Other items.

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Moreover, South Korea would find it a tall order to retaliate. Japan could easily replace any imports from South Korea that fall under an export ban from Seoul. This leaves boycotts by South Korean tourists, who make up 22 percent of Japan's total, as one of the few levers Seoul has. But in contrast to China, South Korea does not have a means of initiating a state-sponsored boycott and would need to

rely on rallying grassroots support from consumers. And with 2020 elections approaching, Moon may choose to heighten his confrontational approach to Japan, which could provide a convenient scapegoat for the country's economic woes.

Ramifications for a Region

Diplomatically, the acrimony with South Korea could stymie Japan's efforts to reach out to North Korea amid the U.S.-North Korea negotiations — an evolving event in Japan's backyard for which Tokyo is on the outside looking in.

Most concretely, the mounting tensions between the two sides could directly affect the Regional Comprehensive Economic Partnership (RCEP), of which both are apart. Already hamstrung by Indian obstinacy, the RCEP could fall apart further as a result of Japanese-South Korean discord. Both countries are also embroiled in talks with China toward a trilateral free trade deal. The China-Japan-South Korea Free Trade Agreement has been floated since 2011 and gone through 15 rounds of talks since March 2013 — most recently in April, although the deepening Japan-South Korea tensions could calve the agreement off into bilateral deals.

Their standoff notwithstanding, Japan and South Korea still share vital interests, with both remaining dependent on the U.S. military umbrella — something that will limit the fallout as Washington has no interest in watching a dispute among critical allies to go too far. But with neither side in the mood for compromise, the current spat between the two East Asian economic giants shows little sign of ending soon. And given that Japan has less economic incentive to bury the hatchet right away, South Korea's leaders will have to decide whether burnishing their nationalist credentials is worth the economic pain awaiting the country.

Source: <https://www.youtube.com/watch?v=64eaowrAGf8>

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