
The Global Impact of the Trade Stand-Off Between Japan and South Korea



By Pushan Dutt , INSEAD Professor of Economics and Political Science

A regional trade tiff has the potential to bring on a global recession.

While the world watches with trepidation as the China-US trade war plays out, a smaller tit-for-tat trade spat between Japan and South Korea threatens the world's tech supply chain and imperils an already uncertain global economy. The dispute involves historical grievances that date back 100 years. However, both countries claim to have imposed their recent trade sanctions in the interests of national security. This weaponising of trade is becoming a worrying trend, normalising the misuse of an exemption to WTO rules with the potential to aggravate future trade disputes across the region.

A threat to global value chains and the world economy

Tensions between the two countries ramped up recently when South Korea refused to re-sign **the military intelligence-sharing pact** it has with Japan and announced plans to remove its neighbour from a list of preferred trading partners. Tokyo has already dumped South Korea from its “white list” of

countries receiving preferential treatment for importing sensitive Japanese-made goods. This had a much greater impact on the world stage as the “sensitive goods” include chemicals crucial to producing semiconductor memory chips – South Korea’s top export item. With manufacturers relying on Japan for their supply, any delay could have severe consequences for the country’s economy and the South Korean won which has already **dropped 8 percent** against the US dollar this year.

South Korean semiconductor giants Samsung Electronics and SK Hynix supply 60 percent of the world’s memory chips and have warned that **they can’t rule out** production disruption if the Japanese export restrictions remain in place. This could significantly impact large global players such as Apple and Lenovo that leverage just-in-time delivery principles to minimise costs.

The dispute has come at a particularly bad time. The world’s major economies are currently experiencing weak growth while uncertainty over the escalating China-US trade war is spooking business investment, confidence and trade flows across the world.

Add to this the chaos surrounding Brexit and businesses are hunkering down. Adopting a wait-and-watch attitude, they postpone investment and wait for clarity amid increasing uncertainty, as **bond markets** send alarming signals of a looming recession.

Trade as a tool of coercion

Another matter of concern globally is Japan’s use of national security to justify its trade policy. This weaponising of trade was used by US President Donald Trump who recently cited security concerns when putting tariffs on steel and aluminium imports. China employed a **similar tactic** in 2017 when it promoted government-sanctioned trade boycotts as South Korea introduced a US anti-ballistic missile system to combat threats from North Korea.

World Trade Organisation rules are to a large extent based on norms. They include a national security exemption **clause** that relies on members applying it in good faith. However, once member states start taking advantage of the provision, we could find trade being used more frequently as a tool of coercion for strategic influence.

China's offer to mediate the dispute

In the past, the US would have stepped in to prevent any flare up between its two East Asian allies from getting out of hand. However, apart from a tepid attempt by US Secretary of State Michael Pompeo to encourage the countries "to find a path forward", the Trump administration has been hesitant to get involved.

In a telling sign of shifting power in the region, China has already offered to **help mediate** the dispute during trilateral talks likely to be held in December.

China considers stability a priority and has been actively seeking to bolster regional economic integration as its relationship with the US sours. China would also be worried about the potential impact the Japan-South Korea trade spat could have on large Chinese technology companies like ZTE and Huawei, which have been targeted in the ongoing trade war with the US and which rely on US suppliers like Qualcomm for chips and semiconductors. If the US trade sanctions cut off this source of supply, they will be looking to South Korea for the vital components. Any continuation of the dispute will accelerate China's long-term goal to develop its own core technologies.

100 years of tension

How effectual China's mediation would be is doubtful given that neither Japan nor South Korea shows any signs of softening. The dispute is an emotional one for both countries and dates back 100 years to Japan's colonisation of the Korean Peninsula. During World War II, Japan conscripted over 670,000 Koreans as forced labourers to support its military ambitions.

The latest escalation of tension coincides with a South Korean high court ruling that Japanese companies should compensate individual victims of forced labour, including the "comfort women" – Korean women taken as sex slaves and forced to work in war-time brothels.

Tokyo insists that the necessary compensation was essentially settled as part of a **US\$500 million** payout under a treaty signed in 1965. However, South Korea says the payout was reparation between governments and the right of individual victims to file a claim has not expired. A new agreement was reached in 2015, where Japan apologised to former "comfort women"

and contributed 1 billion yen (US\$9 million) to a fund to compensate them.

A taskforce created by South Korea's President Moon Jae-in last year found that the 2015 agreement did not reflect the views of the victims, especially their demand that Japan admit direct responsibility. Tokyo's refusal to enter further discussion of this issue has contributed to the deterioration of an already sensitive bilateral relationship.

Pushan Dutt is the Shell Fellow of Economic Transformation and a Professor of Economics and Political Science at INSEAD. He directs **Leading Business Transformation in Asia**, an INSEAD Executive Education programme.

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About the author(s)

Pushan Dutt is a Professor of Economics and Political Science at INSEAD. He teaches in the MBA, EMBA and senior leadership programmes, including the **Advanced Management Programme**, **Leadership Excellence through Awareness and Practice**, and **INSEAD Leadership Programme for Senior Executives**.