

PACIFIC FORUM

# COMPARATIVE

CONNECTIONS

A TRIANNUAL E-JOURNAL OF BILATERAL  
RELATIONS IN THE INDO-PACIFIC

JAPAN-KOREA RELATIONS

## COLD ECONOMICS, COLD POLITICS

JI-YOUNG LEE, AMERICAN UNIVERSITY  
MINTARO OBA, WEST WING WRITERS

It is hard to find anything truly unprecedented in a South Korea-Japan relationship that has long seen periods of elevated tension. That is what makes the recent escalation of disputes into the economic relationship a moment of outsize significance in the history of the relationship. As recently as the last update for *Comparative Connections* in May, we concluded that “South Korea-Japan economic and trade relations have remained ... largely unrelated to political developments and driven by practical considerations.” That assessment reflected the fact that, however high the political tensions, there have been two unwritten red lines: first, allowing political tensions to harm existing, mutually beneficial security cooperation for deterring North Korean provocations, especially when working jointly with the US; second, bringing those tensions into the economic relationship. Over the last four months, those red lines have been blurred in a series of escalating retaliatory moves with direct consequences for both countries and the regional economic and security order as a whole.

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This article is extracted from *Comparative Connections: A Triannual E-Journal of Bilateral Relations in the Indo-Pacific*, Vol. 21, No. 2, September 2019. Preferred citation: Ji-Young Lee and Mintaro Oba, “Japan-Korea Relations,” *Comparative Connections*, Vol. 21, No. 2, pp 105-112.

## South Korea's Court ruling and Japan's export restrictions

In the early months of 2019, the dispute over the Korean forced labor compensation rulings by South Korea's Supreme Court was largely a war of words in public and in diplomatic channels, with no clear impact on the economic relationship. That changed in early July when the Japanese government imposed export restrictions on three chemicals critical to South Korean high-tech manufacturing. The restrictions require Japanese companies to apply for licenses to export the materials to South Korea, giving the Japanese government leverage over whether and how quickly these chemicals reach South Korean companies. Japan cited national security considerations instead of the forced labor dispute as the reason for its move, asserting that a chemical with military applications was exported to North Korea after it had been exported to South Korea. As recently as Sept. 4 op-ed in the *Japan Times*, Foreign Minister Kono Taro reiterated that the forced labor issue "has nothing to do with the recent update by Japan of its export control measures, which was required to ensure the nonproliferation of weapons-related materials. This decision was made solely from the standpoint of national security." Still, media coverage and commentator analysis broadly agreed that the export restrictions were retaliation for the Korean forced labor rulings.

South Korean Supreme Court rulings last year ordered Japanese companies to compensate Koreans who were forced to work for those companies during Japanese colonial rule (1910-1945). South Korean plaintiffs involved in the case subsequently sought to secure the compensation by seizing assets of the Japanese companies. From Japan's point of view, what is at stake is not limited to the legal debate surrounding the issue, as the rulings also raised questions about the broader economic implications of allowing for compensation to the full range of those with claims or potential claims against Japanese companies. If more than [1,300 plaintiffs](#) were to bring cases against Japanese companies, the awards to victims could be as little as [\\$10,000](#) and as much as [\\$133,000](#). According to [one estimate](#), "If all the existing cases were settled at the high end of awards to date, Japanese companies would be liable for approximately \$175 million in compensation." The *Nikkei Asian Review*, citing a figure of more than 200,000 possible claimants, even estimates that the compensation "could swell to \$20 billion or more."

The Japanese government sought to establish a three-member arbitration panel with South Korea and a third country and focused its efforts on getting South Korea to agree to Tokyo's proposal. When Foreign Ministers Kono and Kang Kyung-wha met in late May on the sidelines of an OECD meeting, Kono requested that South Korea accept the idea of an arbitration panel, but Kang avoided giving a direct answer. In mid-June, the South Korean government came up with its own proposal of establishing a fund by Japanese and South Korean

companies to compensate the plaintiffs, which Japan rejected. It appears that both Japan and South Korea hoped to have some kind of breakthrough before the G20 Summit in Osaka. By late June, however, Prime Minister Abe Shinzo said in an interview with *Yomiuri TV* that a summit with President Moon Jae-in will not take place due to his busy schedule. The G20 became a lost opportunity for both South Korea and Japan as their leaders had no real engagement other than shaking hands for eight seconds.

Amid this faltering diplomacy, Japan's decision in July to impose export restrictions was the first step toward linking bilateral diplomatic tensions over history with economics in a manner unprecedented in the relationship. It highlighted both the interconnectedness between Japan, South Korea, and the global economy – and the vulnerability particularly of South Korean export-oriented industries. Japan supplies the vast majority of each of these chemicals on the market, and because Korean manufacturers (specifically Samsung Electronics and SK Hynix, which together account for more than 60% of the global memory chip supply) rely on the chemicals to build semiconductors used by companies like Apple and Huawei in electronic products, restricting or delaying exports could have a ripple effect across global supply chains.

With a "No Japan" movement to boycott Japanese companies and goods gathering steam, the South Korean government responses appealed to popular sentiments. President Moon and one of his top aides Cho Kuk even made references to Korean Gen. Yi Sun-sin who heroically fought against Japanese Gen. Hideyoshi Toyotomi in late 16<sup>th</sup> century. South Korea's major conservative dailies such as *JoongAng Ilbo* and *Chosun Ilbo* criticized Moon's handling of the dispute with Japan for lacking flexibility. Cho Kuk, Moon's first civil affairs secretary and a law professor at Seoul National University (SNU), was criticized by his colleagues for promoting a politically motivated black-and-white logic to instigate anti-Japanese popular sentiments.



Figure 1 South Korean merchants boycott Japanese products. Photo: Japan Times

The South Korean government turned to the United States, not Japan, for a possible diplomatic solution. Foreign Minister Kang had a telephone conversation with US Secretary of State Mike Pompeo and said that Japan's trade restrictions would harm not just South Korea's economy but also have an "undesirable" effect on trilateral cooperation among South Korea, Japan, and the United States. Deputy National Security Advisor Kim Hyun-chong made an unscheduled visit to Washington with the aim of discussing Japan's trade restrictions with Trump administration officials, but received no clear commitment that the US would mediate the dispute. President Trump mentioned offering to help ease tensions, but compared to earlier US administrations, Washington did not show much interest in playing a role in preventing Seoul-Tokyo relations from further deterioration. When the July 18 deadline that Japan set for South Korea to accept its arbitration proposal passed, Foreign Minister Kono summoned South Korean Ambassador to Japan Nam Gwan-pyo and protested angrily, drawing attention from international media outlets. On Aug. 2, Secretary of State Pompeo's meeting with the foreign ministers of the two allies on the sidelines of ASEAN in Bangkok did not change their minds about ongoing bilateral issues.



Figure 2 Kang Kyung-wha, Mike Pompeo, and Taro Kono meet on the sidelines of ASEAN in Bangkok. Photo: Lowy Institute

In the weeks following the export restrictions, the South Korean government sought to demonstrate it was mitigating the economic fallout and shoring up the resilience of the Korean economy. On July 10, South Korea's ruling Democratic Party appropriated ₩300 million in a supplemental budget to support affected Korean companies and localize supply of the critical materials subjected to export restrictions. One week later, on July 17, South Korea's Finance Minister Hong Nam-ki announced that the Korean government was "working on comprehensive plans to reduce the country's dependence on Japan's materials, components and equipment industries." Concern continued to grow among Korean businesses throughout July, with the Federation of Korean Industries urging Seoul not to escalate the dispute, and Samsung's Vice Chairman Lee Jae-yong visiting Japan soon after the export restrictions

were announced in a bid to assure continued supply of the chemicals. At the same time, the export restrictions were also beginning to impact Korean domestic public opinion. Within four days, a petition on the website of South Korea's presidential office, the Blue House, calling on Seoul to retaliate for the restrictions had already gained 17,000 supporters.

South Korean rhetoric remained guarded, emphasizing the importance of unimpeded trade and global supply chains. As South Korea was considering submitting a formal complaint to the World Trade Organization (WTO), South Korea and Japan collided before its highest decision-making body on July 24. Japan's ambassador to the WTO stated that Japan's export restrictions were linked to national security concerns and was a change in trade regulations that Japan had the right to implement. South Korea's ambassador retorted that the restrictions were "not at all a security measure" and "purely strategically planned to gain the upper hand in ... the forced labor issues."

On Aug. 2, Japan broadened its export restrictions by [announcing](#) it would withdraw South Korea from a "whitelist" of preferred trading partners, meaning South Korean imports of 857 items, like the three chemicals, now required Japanese government approval before export. The whitelist removal, which officially took effect Aug. 28, inflamed the dynamics that had been at play in the month after Japan introduced the export restrictions on the chemicals, with the Korean boycott movement gaining momentum and South Korean officials emphasizing the need for countermeasures. South Korea quickly announced it would drop Japan from its own whitelist, indicated it would accelerate its efforts to file a formal WTO complaint against Japan, and funded efforts to develop Korean resilience and self-sufficiency in the affected industries. Korean government rhetoric became more forceful, with President Moon stating that South Korea would "never again lose to Japan."

### GSOMIA and the future of US Indo-Pacific strategy

After a flurry of diplomatic and economic conflicts, ultimately, South Korea responded by withdrawing from the General Security of Military Information Agreement (GSOMIA) with Japan, raising concerns about the future of US-ROK alliance as well as that of tripartite security cooperation between Japan, South Korea, and the US. President Moon announced the decision to scrap GSOMIA on Aug. 22. As a matter of fact, as recently as June 1, the defense ministers of South Korea and Japan, Jeong Kyeong-doo and Takeshi Iwaya, held a closed-door meeting – the first of its kind since they clashed over a radar lock-on incident in December last year – and reportedly shared candid views on bilateral defense cooperation. The next day, defense ministers of Japan, South Korea, and the US met and agreed to cooperate closely with the goal of denuclearizing North Korea. With several constituencies voicing the need to maintain

GSOMIA leading up to the Aug. 22 decision, Moon's decision was somewhat unexpected.

It is helpful to situate this decision in the broader context of South Korea's foreign policy and the East Asian security order. Beyond President Moon and his aides' preferences and styles, there are three factors that explain the particularly challenging Seoul-Tokyo relationship. The first factor is North Korea. In the past, despite the various crises that Seoul and Tokyo went through over history issues, the two governments' desire for maintaining a strong deterrent against North Korea's provocations, especially in the trilateral setting with Washington, used to put a brake on further worsening of relations. For example, Japan's rapid and unequivocal support for South Korean position after the sinking of the South Korean Navy vessel *Cheonan* is a good example of how converging security interests and preferences over North Korea can bring Japan and South Korea together. However, the situation surrounding North Korea has changed. For one, President Trump is pursuing a quasi-engagement policy with North Korea, while Prime Minister Abe was trying to coordinate Japan's North Korea policy with that of Washington, declaring that he would meet Kim Jong Un without any preconditions. For South Korea, the Moon administration prioritized the peace process with North Korea. The deterrence factor that functioned as a glue for trilateral cooperation is missing now.

The second factor is that there is little in the domestic politics both in Japan and South Korea that incentivize Prime Minister Abe and President Moon toward making concessions on economic and history issues and toward getting along with the other side. When Japan announced trade restrictions on key chemicals, there was speculation that Abe was looking to influence an upper house election later that month. Japanese public sentiment and polling data pointed to fairly solid support for Japanese government's position vis-à-vis South Korea, even while certain industries such as tourism in Okinawa suffered a setback from the drop in the number of South Korean visitors. In South Korea, the decision to scrap GSOMIA came in the midst of a scandal surrounding Moon's close aide, Cho Kuk, leading opposition party leaders to accuse the Moon administration of using GSOMIA as a scapegoat to divert public attention away from the scandal. While this may well prove to be wrong, it is true that in terms of domestic politics Moon stood to gain little – in light of past presidents' cases and their polling records – by being soft on Japan, given the strong public sentiment that views Japan's measures as retaliatory.

The third factor has to do with the changing international order with the United States in open competition with China. On the part of the US, the Trump administration treats security cooperation among Japan, South Korea, and the US as integral to the success of its Indo-Pacific strategy, similar to the Obama administration's rebalancing to Asia. However, in South Korea, compared

to their conservative counterparts, policy leaders currently working for the Moon administration tend to view its military alliance with Washington as limiting, as well as helpful, when they seek the kind of foreign policy that affords Seoul more room to pursue improved relations with China. Japan, on the other hand, has proactively put forward the Indo-Pacific concept even before the Trump administration presented it as an official strategy. For South Korea, inter-Korean reconciliation is considered a priority, whereas Japan has shown more interest in participating in the reshaping of a new international order, along with the US and India. In other words, there is a different level of appreciation toward the Indo-Pacific Strategy on the part of Seoul and Tokyo.

### Next few months

As of early September, as the first data points begin to shed light on the South Korea-Japan economic relationship after the export restrictions, whitelist removal, and boycotts, it is clear that the dispute is starting to have negative economic impacts in both countries. August marked the ninth straight month of decline in Korean exports overall – a trend attributable to a range of factors that preceded the Japan-Korea dispute, but was not helped by the 6.2% fall in exports to Japan and a 30.7% decline in the value of Korean semiconductor exports. Korean job seekers also showed signs of turning away from Japan – the most popular place to work for Koreans between 2016-2018, according to Korean government data – with the South Korean Ministry of Labor canceling a job fair for Japan and Southeast Asia due to tensions and other Japan-focused events drawing smaller crowds.

For Japan, much of the economic impact of the dispute has come from a decline in Korean consumption. In July, Japanese auto sales in South Korea fell by 17% year-on-year – but then tumbled 57% in August. Sales of Japanese beer in South Korea dropped 97%. Tourism, an area that has in the past remained resilient despite tensions between the two countries, also suffered. South Korean tourism to Japan fell 7.6% in July, the lowest since weather-related reasons depressed tourism last September. August statistics were not yet available at time of publication. However, citing the decreased Korean tourism to Japan, Korean Air suspended multiple flights to Japan in July and August.

In an effort to blunt the impact of Japan's export restrictions, Samsung, LG Display, and other Korean companies looked to diversify suppliers, including the use of domestic hydrogen fluoride. Japan also granted the first export license for one of the restricted chemicals on Aug. 8, raising hopes that Japan would be flexible about approving exports to South Korea and the overall impact on the Korean economy might be limited. Still, some Japanese observers worried that the drive for self-sufficiency in South Korea prompted by the tensions would ultimately harm Japanese suppliers. "South

Korean companies cite quality and stable supply as reasons for choosing Japanese materials. But this has made them aware of the need for change and they are already taking action," one supplier told [Reuters](#), "This will hit us like a body blow."

While the longer-term strategic impact of the dispute remained unclear, the next few months will offer a clearer picture of how this dispute has impacted the Korean, Japanese, and global economies. One fact was evident as the summer drew to a close: any notion that interdependence would always keep economic activity compartmentalized from bilateral tensions was put to rest by the recent developments. In both countries, economics has been used for political leverage, with direct impacts on consumption, exports, jobs, tourism, and other key sectors, with broader implications for the future of the two countries and the region in which they reside. The unwritten red line, if it existed, was no more.

# CHRONOLOGY OF JAPAN-KOREA RELATIONS

## MAY – AUGUST 2019

**May 6, 2019:** Japanese Prime Minister Abe Shinzo and US President Donald Trump talk by telephone and Abe shares that he would like to meet with Kim Jong Un without any preconditions.

**May 9, 2019:** Senior defense officials of South Korea, Japan, and the US meet in Seoul for the 11<sup>th</sup> annual Defense Trilateral Talks to discuss North Korea's military moves and denuclearization.

**May 10, 2019:** Japanese Chief Cabinet Secretary Suga Yoshihide and Vice President Mike Pence meet and agree that North Korea's ballistic missile firing was regrettable, pledging to work closely together to address the issue.

**May 15, 2019:** South Korean Prime Minister Lee Nak-yeon suggests Japan accept South Korea's position on history to build future-oriented relations and expresses a desire for a summit at the G20 meeting in Osaka in June.

**May 20, 2019:** Japan's Foreign Ministry [announces](#) that it is seeking an arbitration panel to help settle its dispute with South Korea over reparations for wartime forced laborers.

**May 23, 2019:** South Korean Foreign Minister Kang Kyung-wha and Japanese Foreign Minister Kono Taro meet on the sidelines of an OECD meeting.

**June 1, 2019:** South Korean Defense Minister Jeong Kyeong-doo and Japanese Defense Minister Iwaya Takeshi hold a closed-door meeting, the first since the radar lock-on incident.

**June 2, 2019:** Defense ministers of Japan, South Korea, and the US meet and agree to cooperate closely toward the denuclearization of North Korea.

**June 2, 2019:** North Korea's *Korean Central News Agency* calls Prime Minister Abe's proposal for a summit with North Korea "brazen-faced."

**June 13, 2019:** Former Japanese Prime Minister Hatoyama Yukio criticizes Abe and says Japan "should respect the South's court ruling."

**June 19, 2019:** South Korea's Ministry of Foreign Affairs proposes the establishment of a fund by Japanese and Korean companies to compensate the plaintiffs. Foreign Minister Kono rejects South Korea's proposal.

**June 22, 2019:** In an interview with *Yomiuri TV*, Prime Minister Abe states that a summit with South Korean President Moon would not happen due to a busy schedule.

**July 1, 2019:** Japan's Ministry of Economy, Trade and Industry [announces](#) it will restrict the export of "high-tech materials" to South Korea beginning July 4. South Korea's Ministry of Trade [seeks](#) "stern measures" against Japan in response.

**July 4, 2019:** South Korea [dissolves](#) a Japanese-backed foundation that had been providing compensation for former "comfort women."

**July 5, 2019:** South Korean government [halts](#) discussion on joining the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) in light of worsening relations with Japan and "domestic industrial conditions."

**July 8, 2019:** South Korean President Moon Jae-in [urges](#) Japan to retract its restrictions on high-tech materials, denouncing the manipulation of "trade for political ends." ROK political leaders [form](#) a bipartisan delegation to visit Japan to negotiate a resolution.

**July 10, 2019:** Foreign Minister Kang Kyung-wha tells US Secretary of State Mike Pompeo in a phone conversation that Japan's trade restrictions will harm South Korea's economy and have an "undesirable" impact on trilateral cooperation among South Korea, Japan and the United States."

**July 10, 2019:** South Korea's Deputy National Security Advisor Kim Hyun-chong makes an unscheduled visit to the US to discuss Japan's trade restrictions.

**July 13, 2019:** Tokyo [lodges](#) an official protest against Seoul for violating an agreement regarding what information would be disclosed from the July 12 meeting on Japan's export restrictions. Officials from both sides [dispute](#) accounts of what was discussed in the meeting.

**July 18, 2019:** Japanese government calls on South Korea to agree to establish an arbitration board designed to address the results of South Korea's Supreme Court ruling.

**July 19, 2019:** Foreign Minister Kono [summons](#) South Korea's Ambassador Nam Gwan-pyo in Tokyo after South Korea rejects Japan's offer of third-party arbitration to settle the dispute over wartime labor reparations.

**July 19, 2019:** President Trump mentions the Japan-South Korea economic dispute and offers to help ease tension.

**July 31, 2019:** Japanese and South Korean lawmakers meet to ease tension, with little result.

**Aug. 1, 2019:** Foreign Ministers Kono and Kang meet in Bangkok but produce little agreement on bilateral issues. Secretary of State Pompeo also meets trilaterally with Kang and Kono.

**Aug. 2, 2019:** Japan's Cabinet [votes](#) to remove South Korea from its export "white list." President Moon threatens countermeasures including [reconsidering](#) renewal of its military information-sharing deal with Japan.

**Aug. 7, 2019:** Japanese Defense Minister Iwaya Takeshi and US Secretary of Defense Mark Esper agree that the General Security of Military Intelligence Agreement (GSOMIA) between Seoul and Tokyo should be maintained. US Deputy Assistant Secretary of State Marc Knapper highlights the importance of a constructive relationship between the allies in the face of challenges by North Korea, Russia, and China.

**Aug. 12, 2019:** South Korea [downgrades](#) Japan from "most trusted status" to a newly established category, citing Tokyo's violations of "basic principles of the international export control regime."

**Aug. 15, 2019:** President Moon's Korean Independence Day speech strikes a more conciliatory tone toward Japan compared to his previous remarks.

**Aug. 19, 2019:** South Korea retaliates against Japan's delisting of South Korea from their "whitelist" by delisting Japan from its own "whitelist."

**Aug. 21, 2019:** Foreign ministers of China, South Korea, and Japan meet in Beijing. Chinese Foreign Minister Wang Yi says that "While maintaining a constructive attitude, it is important [for Japan and South Korea] to find an appropriate solution through dialogue."

**Aug. 23, 2019:** South Korea [notifies](#) Japan that it will withdraw from the General Security of Military Information Agreement (GSOMIA). Deputy National Security Advisor Hyun Chong Kim says at a press briefing that Seoul "maintained close communications with the United States in the course of reviewing the conflict with Japan as well as GSOMIA."

**Aug. 23, 2019:** US Department of Defense spokesperson says that "the Department of Defense expresses our strong concern and disappointment that the Moon Administration has withheld its renewal of the Republic of Korea's General Security of Military Information Agreement (GSOMIA) with Japan."

**Aug. 24, 2019:** South Korean opposition party leader Na Kyung-won calls the Moon administration's GSOMIA decision a plot to divert South Korean people's attention away from a scandal involving one of President Moon's closest aides.

