



## Background Paper

### **Understanding the THAAD dispute between South Korea and the PRC (Session II Debate: Can Australia counter PRC economic retaliation?)**

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In light of tensions in the Australia-China relationship, it is worthwhile to consider the retaliatory measures taken by the People's Republic of China (PRC) against South Korea as a result of the THAAD dispute.

In March 2017, the United States began deployment of the Terminal High Altitude Area Defense (THAAD), an anti-ballistic missile system, to South Korea. The PRC protested vehemently. From Beijing's perspective, THAAD's proximity to the PRC and its advanced radar detection erodes the PRC's nuclear deterrent by collecting data on its missile forces. South Korea and the United States denied this. They offered to provide details of the mechanics of the THAAD system and allow the PRC to inspect THAAD sites. However, the PRC refused the offers, and chose instead to launch a barrage of retaliatory trade actions.

The Bank of Korea estimates that the THAAD dispute cut South Korea's GDP growth rate by 0.4 per cent in 2017. Hyundai's sales dropped 60 per cent and its affiliate Kia's sales dropped 54 per cent in the second quarter of 2017. AmorePacific, a Korean cosmetics conglomerate, saw operating profits drop 58 per cent in the same period. South Korean bands were denied visas to perform in the PRC, and popular South Korean shows disappeared from PRC TV and streaming services.

In South Korea, tourist numbers plummeted. After Beijing instructed both private and state-owned travel agencies to stop selling group tours to South Korea, the number of PRC tourists visiting the country dropped 48 per cent from the previous year. It resulted in an A\$6.17 billion loss to the economy and the largest deficit ever recorded on South Korea's services account. This led to the closure of 90 per cent of the 160 South Korean travel agencies specialising in PRC tourists.

However, as Dr Chaibong Hahm, head of the Seoul-based Asan Institute for Policy Studies, notes, the PRC's trade-focused retaliatory measures were limited to exports of consumer goods and tourism. In the first half of 2017, South Korean exports to the PRC actually rose 12 per cent overall year on year. PRC firms that rely on South Korean supply chains, for example those requiring semiconductors and automobile parts, continued to import as usual. Entertainment and tourism, the industries hardest hit by PRC actions, make up at most 5 per cent of South Korea's exports to the PRC.

Despite the drop in tourist numbers, duty-free shops reported record high sales due to increased purchases by PRC resellers. The number of PRC students in South Korea also grew.

The hardest hit business was Lotte Group, the company that had granted the South Korean defence ministry use of its land for the THAAD system. On the pretext of fire safety breaches, Lotte was forced by PRC authorities to close 90 per cent of its hypermarket stores in the PRC. The THAAD dispute was not cost-free for the PRC. The dispute cost the PRC A\$1.16 billion or 0.01 per cent of GDP. It led to a halving of South Korean visitors from March to May 2017.

The election of President Moon Jae-in in May 2017 paved the way for a defusing of the standoff between Seoul and Beijing. Moon, unlike his predecessor, was highly critical of THAAD. Though the

increased threat from North Korea forced Moon to allow the four remaining THAAD launchers to be deployed in September 2017, two months later South Korea and the PRC agreed to normalise exchanges. South Korea pledged not to deploy further anti-ballistic missile systems, not to join a regional defence system involving the US, and not to enter a trilateral military alliance with the US and Japan.

Dr Hahm describes the way the South Korean government handled the THAAD dispute as “humiliating”. In his view, South Korea should have stood its ground and implemented THAAD according to schedule to safeguard its national security. Due to the interdependence of the two countries’ economies and the PRC’s dependence on global supply chains, South Korea should have been more confident that the PRC would be unlikely to disrupt a vital source of imports. The economic damage to South Korea was minimal, Hahm says.

“So some cosmetic companies are suffering, our K-pop stars might not be able to go to China. At the micro level it is a big deal, but our foreign trade volume is huge”, Hahm emphasises. “If they want to place sanctions on us, it would also hurt their own economy. So China is very careful not to touch the major component of economic ties.”

The South Korean case is an example of the PRC’s use of economic coercion to dissuade another country from acting in a way it views as detrimental to PRC interests. In the THAAD case, Beijing reacted because it judged that its security interests were being undermined. Hahm notes that it is possible that the PRC used “security interests” as an excuse to test South Korea’s resolve as well as the strength of the US-South Korea alliance. It is worthwhile to note that current tensions in Australia-China relations did not arise as a result of a similar perceived security threat to the PRC. Nevertheless, the South Korean case provides insight into the complexities of PRC attempts at economic punishment.

Other examples of PRC retaliation also indicate that the PRC targets sectors in which any negative impact on its own economic interests is minimal. For instance, in 2012 Beijing restricted tourism to and fruit imports from the Philippines over a territorial dispute in the South China Sea. When Liu Xiaobo was awarded the Nobel Peace Prize in 2010, the PRC blocked imports of salmon from Norway. In both cases, punitive measures only ceased after the country being punished reached out to Beijing.

## Questions

Is there a lesson to be learned from the THAAD crisis?

Should Australia take a stand on values-based issues with the PRC even when these might court retaliation, and if so, what should those issues be?

What issues could lead to the current diplomatic freeze becoming economic retaliation by the PRC?

What are the red lines, for Australia and the PRC?



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