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Re-evaluating U.S. Trade Relations
with the Asia-Pacific Region

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Re-evaluating U.S. Trade Relations with the Asia-Pacific Region

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TABLE OF CONTENTS

Executive Summary	3
Chapter 1: U.S.-Asia-Pacific Trade and Investment Policy	4
Chapter 2: Geopolitics and its Correlation to International Trade	12
Chapter 3: The Rise of China and Its Relationship with the U.S.	20
Chapter 4: Chinese Investment in High Technology	30
Chapter 5: Cybersecurity and Intellectual Property Theft with China	39
Chapter 6: A New Age of Trade: U.S.-Japan-South Korea	50
Chapter 7: U.S.-Japan Trade Relations	62
Chapter 8: U.S.-Korea Trade Relations	75
Conclusion	86
Policy Recommendations	87
Bibliography	90

EXECUTIVE SUMMARY

This Task Force is focused on the complex issues of U.S. trade and investment policy with countries in the Asia-Pacific. Specifically, this report looks at historical and contemporary relations of the U.S. with China, Japan, and South Korea to recommend viable policy options to the United States Trade Representative (USTR). President Trump's concern with U.S. trade deficits has evolved into harmful policy measures, such as the implementation of tariffs, creating lasting economic and diplomatic consequences for the U.S. in the region. These actions reflect his view that foreign trade is negatively impacting domestic jobs and industries, and therefore require protectionist policies. In the case of China, the biggest issues facing the U.S. are China's rise economically and geopolitically, cybersecurity, intellectual property theft, and forced technology transfers. For Japan and South Korea, conflicts over tariff escalation and strains in diplomatic relations need to be addressed. Our analysis of these issues leads us to recommend policy options in six main areas:

Diplomacy: The U.S. should approach all diplomatic negotiations with China, Japan, and South Korea with an emphasis on cultural consideration and privacy.

Tariffs: In the short-term, the U.S. should utilize current leverage on China through tariffs yet remove them once progress is made. Tariffs, or the threat of tariffs, on Japan and South Korea should be removed immediately to encourage strong alliances.

Investment: The U.S. needs to encourage further inbound and outbound investment with Japan and South Korea to strengthen economic ties against the rise of China. The U.S. should also re-evaluate current investment practices with China, such as joint ventures, that are harmful to U.S. companies and national security.

Cybersecurity and Intellectual Property Theft: The U.S. should bolster intellectual property and cyber protection measures to combat cases of espionage.

Trilateral Agreement: A trilateral agreement between the U.S., Japan, and South Korea would formalize alliances and the commitment to increased investment.

International Institutions: The U.S. should utilize international forums such as the World Trade Organization as a tool to advance ideals of free trade and reciprocity with China.

U.S.-ASIA-PACIFIC TRADE AND INVESTMENT RELATIONS

Rachel Roberts

Introduction

The United States has an extensive trade relationship with Asia-Pacific nations. Two-way trade between the U.S. and the Asia-Pacific Economic Cooperation (APEC) countries totaled \$2.6 trillion in 2017.¹ Exports to APEC countries accounted for 62.9% of all U.S. exports in 2017, making the region a substantial actor in U.S. international trade.² In recent years the U.S. has shifted its attention towards trade in the Asia-Pacific, causing tensions to arise. President Trump's election in 2016 re-oriented the nation's top priorities away from the conflict in the Middle East and focused instead on lowering the trade deficit, specifically in these countries. The Trump administration created a trade war by placing 10% tariffs on around \$200 billion worth of Chinese imports, along with placing 25% tariffs on imports of Japanese steel and 10% on Japanese aluminum.³ Trump's departure from the U.S. norm of free-trade promotion through the implementation of tariffs, the challenging of international institutions like the World Trade Organization (WTO), and the abandoning of the Trans-Pacific Partnership (TPP), makes it imperative to re-evaluate the values and ideals of the United States and its trading system.

For the purpose of this report, we are focusing on China, Japan, and Korea. In the chapters to follow, an in-depth analysis will be provided on specific country relations as well as detailed policy recommendations for the regions in order to promote positive future trade and investment practices.

Why is a Major Trade War Occurring Now?

President Trump has brought attention to trade and investment policy with Asia-Pacific nations that was not discussed in such detail for decades. In 2001, the United States' attention turned to the Middle East after the attacks on 9/11. More specifically, the Presidential terms of George W. Bush and Barack Obama focused their attention on this region. Military intervention was key in order to prevent

¹ "Asia-Pacific Economic Cooperation," Summary of the U.S.-Australia Free Trade Agreement, Office of the United States Trade Representative, accessed February 05, 2019, <https://ustr.gov/countries-regions/japan-korea-apec/apec>.

² "Asia-Pacific Economic Cooperation."

³ "USTR Finalizes Tariffs on \$200 Billion of Chinese Imports in Response to China's Unfair Trade Practices," Summary of the U.S.-Australia Free Trade Agreement, Office of the United States Trade Representative, September 18, 2018, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/september/ustr-finalizes-tariffs-200>.

any further terrorist attacks and maintain strong domestic and international security.⁴ Also in 2001, China joined the WTO. Typically, the WTO requires a country to fully integrate free trade regulations within ten years. However, with the U.S. focused mainly on the Middle East, China has been slow to comply with these standards after 18 years. Now, as awareness turns towards China's rapid economic rise, countries like the United States, Canada, and Japan are not pleased with how the Chinese are implementing "trade-distorting non-market economic policies."⁵ These countries are currently discussing how to change the WTO rules, which have not been altered since its establishment in 1995. China is challenging the multilateral trading system by aiding its domestic firms at the expense of foreign competitors to slip through the cracks of the WTO rules and regulations.⁶ The country's mercantilist approach is what is making headlines and causing other developed nations to worry about the future of international trade and the U.S.-led world order that has existed since the end of World War II.

Goals of the United States

The U.S. national interests in the Asia-Pacific region are focused on maintaining stability. By upholding a strong relationship with our allies in the region, we can foster our economic power in the global system and our political influence as well. The United States benefits from a stable world-order governed by existing international institutions such as the WTO. Utilizing the WTO as a tool to hold China accountable is consistent with the U.S. interest of maintaining stability through established international institutions, which are representative of shared values such as reciprocity.

China, although a relatively new player in the international arena, has experienced exponential growth and has risen to a dominant position of power in the region. It is in the national interest of the U.S. to contain China's rise, so there is a more equal playing field for its trading partners, like Japan and South Korea. With new economic improvement strategies such as *Made in China 2025* and the Belt and Road Initiative (BRI), China is trying to build up strong high-tech industries and also create a Silk Road 2.0 to increase its market access to many countries along the route from China to Europe. In order to adjust to China's rise, the U.S. must secure relations with the nations surrounding China, especially Japan and Korea to ensure regional stability.

⁴ Cheng Li, "Assessing U.S.-China Relations under the Obama Administration," *Brookings Institute*, September 05, 2016, <https://www.brookings.edu/opinions/assessing-u-s-china-relations-under-the-obama-administration/>.

⁵ David Lawder, "U.S. Trade Agency Sees Negotiating New WTO Rules to Rein in China as futile," Reuters, February 05, 2019, <https://uk.reuters.com/article/us-usa-trade-china/u-s-trade-agency-sees-negotiating-new-wto-rules-to-rein-in-china-as-futile-idUKKCN1PT2EA>.

⁶ Lawder, "U.S. Trade Agency Negotiation WTO."

Bilateral and multilateral agreements are important tools the United States can use to reach goals of maintaining a stable global system. Maintaining stability can also be reached through urging the WTO to hold China accountable to the institutional rules governing international trade. This would result in China having more responsibility to open its markets to other nations rather than enjoying the benefits of the WTO without the restrictions. Utilizing the forum of the WTO to discuss trade disputes between the U.S. and China could foster a healthier relationship based on reciprocity, a core WTO value.

Upholding global stability involves more underlying trade issues other than multilateral agreements and imposing tariffs. One key trade issue that is undermining global stability is the massive thefts of technology through hacking by Chinese operatives, some tied to the Chinese government. Also, the U.S. and other foreign firms are unhappy with being forced to hand over their proprietary technology in joint ventures. As a result, several companies in the United States chose not to enter the Chinese market in fear of having their technology stolen. As China continues to upgrade its economy towards a technology-based manufacturing sector, it is in the United States' best interest to focus on securing its intellectual property rights to reduce Chinese expansion and espionage. We see the resolution of these trade problems as a key way to contribute to global stability. As we dive further into the report, our goals will be explained in greater detail followed by policy recommendations.

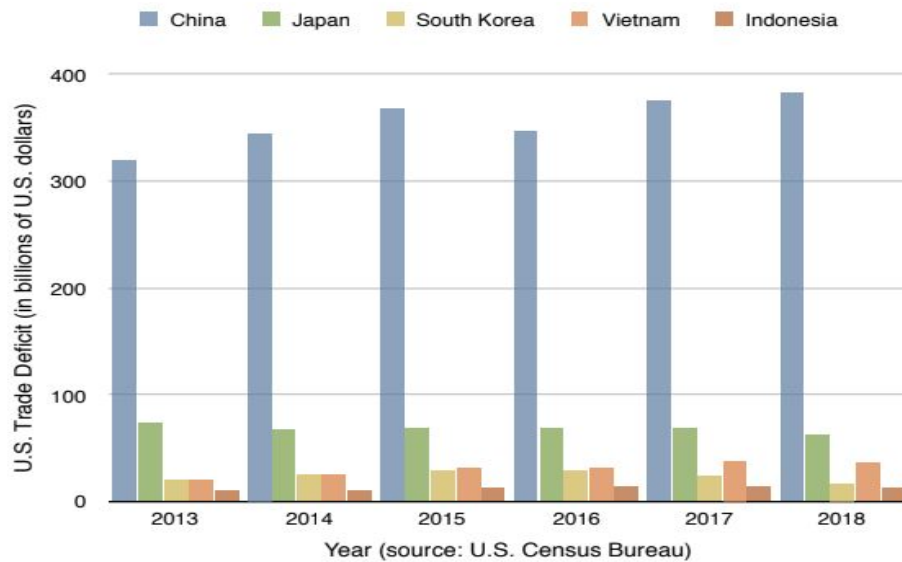
Introduction to Trade Conflicts

Historically, the United States has maintained positive relations with countries in the Asia-Pacific region. Geographic location and historical ties have led to strong alliances. Yet, actions taken by President Trump do not reflect these long-standing relationships.

Trade War with China

In recent months, the United States has created a hostile environment with China regarding trade and trade policy. In 2017 alone, the U.S. trade deficit with China resulted in \$375 billion, with \$506 billion being imported into the United States and \$130 billion being exported to China.⁷ Some of the largest U.S. imports from China include computers, cellphones, apparel, and footwear while China imports a heavy amount of commercial aircraft, soybeans, and autos. In the beginning half of 2018, the trade deficit with China was \$222.6 billion.

⁷ Kimberly Amadeo, "The Real Reason American Jobs Are Going to China," *The Balance*, January 18, 2019, <https://www.thebalance.com/u-s-china-trade-deficit-causes-effects-and-solutions-3306277>.



The Trump administration, in a very protectionist, even mercantilist, approach is currently enforcing tariffs of 10% on \$200 billions of Chinese goods. Trump revoked his threat of increasing them to 25% on March 1st, as long as a mutually beneficial deal is made to this major trade war. In order to maintain a civil relationship with China, it would be in the interest of the United States to not increase tariffs any further than 10%.

The U.S.-China trade conflict is further complicated by Chinese domestic politics and geopolitical relations in the region, among other factors. For China to have a healthy economy that is a responsible member of the WTO and the current world order, they need to focus more on allowing private firms, including foreign ones, to grow, rather than use industrial targeting policies and government subsidies to build up state-owned enterprises (SOEs) in major industries. Trump believes that having China to buy more American goods will lead to a decrease in the trade deficit. In reality, this solution will not solve all of the problems presented.

The current animosity between the United States and China goes far beyond trade into a highly complicated geopolitical realm related to threats to cybersecurity, theft of intellectual property, corporate espionage, manipulation of currency, and overall dominance in the global order. The geopolitical relationship between the United States and China will be further discussed in the following chapter.

Tariffs on Japan

The enmity between the United States and China leads us into a discussion about what to do with another significant Asia-Pacific country, Japan. After the end of World War II, Japan and the U.S. have had a very close military alliance and tight economic and political relations, such that Japan is the

United States' most important ally in the Asia-Pacific region. With the United States recently retracting its membership in the Trans-Pacific Partnership, there needs to be an agreement made with Japan in order to maintain a strong trade relationship. On September 26th, 2018, President Trump and Prime Minister Abe declared they would begin negotiating a bilateral agreement.⁸ An agreement is necessary to counter Chinese expansion and uphold forceful relations to, in results, preserve global stability specifically in this region. However, the Trump administration decided to place tariffs on Japanese steel and aluminum while also threatening substantial tariffs on cars and auto parts.⁹ The U.S. is the largest importer of steel in the world. Any tariffs placed on steel by the Trump administration will in return hurt U.S. consumers greatly as Americans rely on steel for improving infrastructure and automotive. Japan, being our biggest ally in the region, should not have tariffs imposed on their exports to maintain a positive relationship.

Alliance with South Korea

As for South Korea, the circumstances come down to maintaining a positive relationship not only for trade purposes but also for protection against possible nuclear retaliation from North Korea. The U.S. and South Korea have supported each other through several decades of wars, creating an alliance that should be regarded with mutual respect. The United States and Korea already have an established bilateral free trade agreement (FTA), KORUS, which was created in 2007 and went into effect in 2012. This agreement was revised by President Trump and South Korea's President Moon Jae-in on September 24th, 2018.¹⁰ Revisions to KORUS include increased reciprocity in the auto sector. It is important to recognize a quota was put in place to limit the quantity of steel imported into the U.S. at 70% of what it was originally.¹¹ Rather than pulling out of the 2012 agreement, Trump renegotiated KORUS to help uphold a strong growing U.S. economy that relies heavily on trade with Korea. Trade problems with Korea are less important than cooperation with the U.S. so the U.S. can push for peaceful denuclearization of North Korea. Because North Korea now has the capability to reach major U.S. cities with nuclear missiles, it is of utmost importance that the U.S. do whatever it can to maintain a strong relationship with South Korea.

⁸ Rintaro, Tobita, "US-Japan Trade Talks Face Delay as Trump Focuses on China," *Nikkei Asian Review*, January 24, 2019, <https://asia.nikkei.com/Economy/Trade-War/US-Japan-trade-talks-face-delay-as-Trump-focuses-on-China>.

⁹ "Japan - Import Tariffs." export.gov, last modified August 31, 2018, <https://www.export.gov/article?id=Japan-Import-Tariffs>.

¹⁰ "U.S. - Korea Free Trade Agreement." Summary of the U.S.-Australia Free Trade Agreement, *Office of the United States Trade Representative*, <https://ustr.gov/countries-regions/japan-korea-apec/apec>.

¹¹ Aidan Camas, "Trump Signs Revised United States-Korea Free Trade Agreement (KORUS)," *Worldwide ERC*, accessed February 05, 2019, <https://www.worldwideerc.org/article/trump-signs-revised-united-states-korea-free-trade-agreement-korus>.

Looking at the commonality between the U.S. and its relationships with Japan and Korea, although extremely different, both nations are needed as strong U.S. allies. In the long run, a trilateral agreement between the United States, Japan, and South Korea would be ideal for containing China from expansion and protecting relations with nations, such as South Korea, in the Asia-Pacific region.

Trump's Current Rhetoric on Trade and Its Implications

Trump's rhetoric is important to understand when it comes to where these trade disputes have originated from. While campaigning in 2016, Trump argued that trade with Asia-Pacific nations and their respective trade deficits are one of the leading causes of problems experienced by his base, namely: loss of American jobs in the manufacturing and coal industries and the feeling of disenfranchisement within the middle class. Trump's framing of international trade is politically powerful and has serious negative implications for trade policy and our relationships in the region. Trump's imposition of tariffs will not help in the long run, as it will ultimately negatively affect Americans because countries retaliate by imposing tariffs back.

This Task Force builds off the idea that the U.S. trade balance is not a crucial issue that needs to be addressed in international trade policy. The current administration portrays bilateral trade deficits as highly problematic, warranting the implementation of tariffs. However, this report believes our current bilateral trade deficits are not issues that need aggressive action and secondly that tariffs will not be effective to reduce this deficit. While it is a problem that the U.S. has a large overall trade deficit, this is caused by the fact that the U.S. imports more than it produces and exports. This is a macroeconomic problem that cannot be solved simply by China or Japan buying more U.S. goods. Since the U.S. has not dealt with this problem of consuming more than it produces, the U.S. government has essentially accepted that we will continue to go into debt to foreign nations. While this creates an imbalance of more dollars flowing out of the U.S. into other countries, these same countries are re-investing in U.S. Treasury bonds and stocks. Bilateral deficits specifically are also not a cause for worry. In the case of China, the imbalance itself is not problematic; however, factors exacerbating the deficit can be, such as currency manipulation, subsidies to SOEs, and forced technology transfers. These cycles of capital flows only become destabilizing for the U.S. if countries start believing the U.S. is a risky investment, which this report does not anticipate happening any time soon.

Furthermore, tariffs are not the answer to reduce this deficit for two reasons: firstly, the trade balance is a function of more than exports and imports. Factors including investment, private savings, and government spending all play a vital role in a positive or negative balance, and tariffs will not be effective in targeting these areas. In addition, while tariffs may appear to target other countries, tariffs

are harmful to the consumers of the importing country as domestic companies and consumers pay the tariffs, not foreign companies.¹²

Rather than focusing on tariffs, attention should shift, for example, to the amount of stealing of intellectual property and forced technology transfers which will be discussed in Chapter 5 of this report.

¹³ If President Trump continues to use protectionist rhetoric, it will result in negative relations with South Korea and China, which would ultimately exacerbate our concerns surrounding North Korea. The North Korea problem will be explored further in the report, showing how security threats from North Korea could transpire if relations were to deteriorate with neighboring nations seriously. With Japan, the American government is focusing less on the trade deficit because increasing prices on Japanese cars is something American consumers would oppose, and the United States needs military entente with Japan to contain North Korea.¹⁴

President Trump is moving the United States in the direction of isolationism by replacing multilateral agreements with strictly bilateral ones. Rather than negotiating the agreements, Trump uses a zero-sum based negotiation approach to uphold U.S. power in the global system.¹⁵ At the start of his term, the President threatened to leave the WTO, but he is not taking action on this statement. The U.S. should isolate itself from these multilateral institutions; rather the U.S. should be trying to put itself everywhere to show dominance. It is also worth noting for the long-run that this trade conflict with China, although instigated by President Trump, is very likely to continue long beyond his term in office. It is true that Bush and Obama did not pursue this issue in great detail, although Obama started to near the end of his term with the development of the TPP. As mentioned earlier, both Presidents were focused on wars in the Middle East. Obama also had to deal with the greatest recession since the Great Depression. Both political parties do agree on the fact that something must be done about China, showing the potential for bipartisan support on this issue. The President's redundant rhetoric, whether on social media or in public, towards these Asia-Pacific allies, reflects not only on himself but the American people too. These actions are creating an increasingly hostile environment where, culturally, these Asia-Pacific nations feel they do not share the same values and customs as the Trump administration. We believe emphasizing a strong representation of U.S. diplomatic integrity will help ease tensions with allies the U.S. relies heavily on for the trade and investment atmosphere.

¹² Charles Sawyer, *U.S. International Trade Policy: An Introduction* (Santa Barbara, California: Praeger, 2017).

¹³ Alan Rappeport, "Trade Talks with China Open in Washington, as Obstacles Abound," *The New York Times*, January 30, 2019, <https://www.nytimes.com/2019/01/30/business/us-china-trade-talks-trump-tariffs.html>.

¹⁴ David Jacoby, *Trump, Trade, and the End of Globalization* (Praeger, 2018).

¹⁵ Jacoby, *Trump, Trade, and the End of Globalization*.

Conclusion

As we dive further into this report, a close-up analysis of trade relations with each Asia-Pacific country will be provided to decipher what policies will best be suited for the future of the American regime. Chapter 2 will emphasize the importance of military and geopolitical factors in the region, and briefly outline the military alliances that play into trade relationships. Chapters 3 and 4 focus specifically on the problematic relationships between foreign companies that invest in China and Chinese manufacturing companies, due to the fact that foreign companies are often forced to make joint ventures. Chapter 5 narrows in on several problems the U.S. has with China stealing its technology and forcing firms to transfer their technology in order to gain access to the Chinese market, and Chinese hacking of U.S. government and business systems with the aim of stealing information and disrupting normal operations. Chapter 6 covers U.S. relationships with our two primary Asian allies, Japan and Korea, looking at our trade and military ties. Chapter 7 focuses on U.S. trade problems with Japan and their steel, aluminum, and automobile industries. Finally, Chapter 8 discusses South Korea as a vibrant economy with a successful bilateral trade agreement with the U.S. in place. This Chapter highlights trade issues but also the problem of North Korea's nuclear missile capacity. South Korea has a complicated situation as it shares a border with North Korea and is very close geographically and economically to China. The goal of this report is to clearly identify specific aspects of each country's trade policies which most pose a problem to U.S. interests, and propose policy recommendations to best address each of those trade problems, in order to best benefit the future economy of the United States and the U.S.-led world order.

GEOPOLITICS AND ITS CORRELATION TO INTERNATIONAL TRADE

Gavin Hashimoto

Introduction

Since the end of the Cold War, the United States' role as a single global hegemon has not been threatened or brought into question. As such, certain scholars have labeled America's unparalleled economic, cultural, and political influence over the world as the world's only example of a "hyperpower," the *Pax Americana*, among others.¹⁶ As the 21st century continues, however, China's unprecedented economic rise - along with its increasing global ambitions and general lack of willingness to operate within the existing liberal international world order - has triggered suspicions and overt concern from the United States that its position as the paramount global power is existentially threatened. Underscoring the tension between the two countries is a fundamental difference of opinion on how governments should operate towards one another within the international sphere. Further complicating the issue is the rapidly evolving context in which the U.S. and China interact. While the United States increasingly turns inward and away from the multilateral, institution-based order that was constructed after World War II, China is becoming ever more ambitious and proactive under the domineering hand of President Xi Jinping. The conflict appears to be escalating as trade tensions and questions of Chinese military extensions into the region dominate news headlines. While these factors are important for understanding the overall context in which the two countries operate, it is also important to analyze the issue through a broader lens. The wider scope of geopolitical relations allows us to examine how and why the U.S.-China regional conflict affects the broader trade conflict within the Asia-Pacific region.

While U.S.-China tensions cannot be easily explained, understanding fundamental geopolitical relations provide insights into much of the current discourse and differences of opinion between the two. Especially if we are to consider the question of future U.S. trade policy with the Asia-Pacific region, we must analyze the particular geopolitical issues that affect the policy direction of the U.S. Geopolitical relations are key to understanding trade policy. Therefore, we will see that recommendations about trade policy will intersect topics of military activity, regional institutions, intellectual property, participation in international organizations, global finance, and more. Ultimately, geopolitics is

¹⁶ Eliot Cohen, "History and the Hyperpower," *Foreign Affairs*, 2004.
<https://www.foreignaffairs.com/articles/united-states/2004-07-01/history-and-hyperpower>.

indispensable for gaining an understanding of the broader region and will help inform policy analysis in closer examinations of other important states in the region.

It is necessary to understand the specific context in which geopolitical conflicts arise. Headline-grabbing events like Chinese forays into the South China Sea and ongoing tensions on the Korean Peninsula are to a certain extent all symptoms of the wider context in which state actors operate. The root causes of many of these conflicts have more structural origins, which can generally be understood as the inherent conflict between two potential hegemonic powers. The classical Thucydides Trap principle appears, on the surface, to be applicable here. If we are to interpret the actions of these two hegemonies as the natural course of behavior of rationally-behaving states, then the conflict itself seems to make more sense. The Chinese, in this case, are aggressive because they are the rising power, whose legitimacy on the world stage depends, to a certain extent, upon usurping the power of the existent authority. The United States, in this case, behaves reactionarily and does not appreciate any encroachment upon its privileged status as the preeminent power. This interpretation generally fits the reality that we observe, at least in the realm of geopolitics. The question for the United States, then, is how to deal in a manner which advantages the U.S. to the greatest extent while accommodating or otherwise managing China's rising economic and political power. There will always be opportunities for mutually beneficial arrangements between the two, but in a world where the two powers have such conflicting value-systems, it seems more advantageous for the United States to deliberately act in its own self-interest, at the expense of the Chinese.

The United States has never been the preeminent and undisputed world power without at least a token participation in international cooperative efforts. Moreover, it was only through participating in the liberal, multilateral world system that it took the mantle of global hegemon. These realizations - that a U.S. advance likely entails a regression of Chinese power and that the height of U.S. power came during a period of international cooperation - lead us to conclude that continued U.S. dominance will require a re-engagement with the liberal principles and commitment to multilateralism which characterized the U.S. rise to power originally. At this point in time, however, the dominant narrative which characterizes the U.S.-Chinese relationship is that of the "rising power vs. declining hegemon."

China's Geopolitical Rise

Understanding China's rise to global prominence is not important so much for characterizing how their stunning economic growth might be replicated, but more so to understand how their past may affect their future course of action. It is clear that the constant and rapid rise in economic power may have imbued the Chinese government with an extreme sense of confidence. Without postulating

too much, we can presume that the economic success of China plays a vital role in telling the story of China today. In regard to their interactions with other states, especially their geographical neighbors, China's economic power is precisely the reason why it is such a dominant force in the region. Anecdotally speaking, we can observe that China's power comes not from so-called "soft power," but rather the size of its domestic market, capacity for large-scale manufacturing processes, and increasingly specialized labor force.¹⁷ This is in contrast to the United States, for example, whose global prestige relies not only upon its economic and military power but also its status as the worldwide dominant force in culture. Economic indicators clearly demonstrate the precipitous rise in Chinese capacity in recent years: In 2000, Chinese exports of goods and services amounted to one-fourth that of the U.S., around \$250 billion. Only 13 years later, China started to pass the United States as both countries exported \$2.2 trillion.¹⁸ In 2004 China passed the United States as the world's largest exporter of high-technology¹⁹ and has made impressive strides in closing the gap in logistical capacity with the United States.²⁰

While there are concerns with the slowdown in the Chinese economy, the overall expansion of the economy as a whole is likely to continue for the foreseeable future. In time, the U.S. will confront China not as an economic peer, but as the undisputed global economic leader. This reality has ramifications across the region and informs some of the geopolitical decisions of the leadership of Asia-Pacific states. In particular, in light of rising U.S.-Chinese tensions since the inauguration of President Trump, and instability within the traditional alliance between Japan and the U.S., China's leadership has taken it upon itself to court Japanese markets for investment and trade in general.²¹ This observation, while perhaps isolated within the overall context of relations between the three nations, is still pertinent because of its seeming unusualness. It would not be an overstatement to say that these kinds of changes in the balance of power - wherein China appropriates a traditionally American relationship - will become more of a pattern in the future.

This is true not only for states with cordial relations with the U.S. but also traditionally antagonistic powers. In the sphere of geopolitical relations, oftentimes the mutual adversary becomes closer to the original state. It should not be understated, then, that Russia as a regional stakeholder has

¹⁷ Mark Beeson, "Alternative Realities: Explaining Security in the Asia-Pacific," *Review of International Studies* 43 no. 3 (July 2017), <https://doi.org/10.1017/S0260210517000018>.

¹⁸ "Exports of Goods and Services (Current US\$)," World Bank, accessed February 02, 2019, <https://data.worldbank.org/indicator/NE.EXP.GNFS.CD?locations=CN-US>.

¹⁹ "High-Technology Exports (Current US\$)," World Bank, accessed February 02, 2019, <https://data.worldbank.org/indicator/NE.EXP.GNFS.CD?locations=CN-US>.

²⁰ "Logistics Performance Index: Overall (1=low to 5=high)," World Bank, accessed February 02, 2019, <https://data.worldbank.org/indicator/LP.LPI.OVRL.XQ?locations=US-CN&view=chart>.

²¹ Catherine Putz, "The Art of the Balance: Japan, China and the United States." *The Diplomat*, accessed February 02, 2019, <https://thediplomat.com/2019/01/the-art-of-the-balance-japan-china-and-the-united-states/>.

great impact. While traditionally thought of as a European or European-esque power, Russia's continued engagement with China and, the region in general, plays a factor in some important geopolitical decisions recently. While China is the dominant power between the two, especially with respect to the Asia-Pacific region, both have shown an affinity and mutual respect for each other's unique brand of multilateralism, which prioritizes respect for state sovereignty, lack of emphasis on human rights as a unifying tool, and a generally more realist approach to international relations.²² This has ultimately resulted in large-scale joint military drills, which are now being conducted with increasing frequency and scale.²³ This appears to be a direct rebuke to the United States and its military projection in the region.

Geopolitics and Military Power

Alongside China's steep economic rise has been an equivalent and a corollary increase in its willingness to flex its military might. The American military is traditionally the most expeditionary fighting force in the world, with bases across nearly every continent, and having forward-deployed soldiers be the norm. As such, the U.S. military can and does impart a political force on countries around the world, without actually engaging in offensive operations. China's claim to the South China Sea, as well as the increasingly militaristic Belt and Road Initiative (BRI), represents a fundamental shift in the conception of the Chinese military as a power-projection force within the region. Traditionally, the U.S. did not have an organized military force belonging to an adversary which could effectively threaten the overall accomplishment of the mission in the region. The other two strongest militaries in the region belong to key U.S. allies: South Korea and Japan. Furthermore, U.S. troop deployments in these regions guaranteed that effective hegemony was achieved. Now, in the face of a combative and adversarial relationship with China - and rapidly rising Chinese investment in military expenditures and increasing sophistication of military technology - the U.S. finds its position as regional hegemon threatened.

China is not using this as an end unto itself, but rather the means by which China will carve out a regional sphere of influence which cannot be intruded upon by outsiders. This, according to President Xi, the "New Model of Great Power Relations," in which China and the U.S. will only cooperate in security matters on issues which involve the world in general.²⁴ This ideology clearly informs much of the

²² Yaroslav Trofimov, "The New Beijing-Moscow Axis," *Wall Street Journal*, February 01, 2019, <https://www.wsj.com/articles/the-new-beijing-moscow-axis-11549036661>.

²³ Jesse Johnson, "Chinese Military to Join 'Unprecedented' Russian Joint Exercises for First Time," *The Japan Times*, August 22, 2018, <https://www.japantimes.co.jp/news/2018/08/22/asia-pacific/chinese-military-join-unprecedented-russian-joint-exercises-first-time/>.

²⁴ Hochul Lee, "Power Politics Behind the Transforming Geopolitics in East Asia," *East Asia* 34 no. 4 (December 1, 2017): 318, <https://doi.org/10.1007/s12140-017-9280-3>.

posturing on the international level on an everyday basis, as China uses a guise of non-interventionism and respect for sovereignty in order to increase influence over its neighbors. The United States sees this as a threat to its dominance and has made aggressive posturing moves itself by deploying carrier strike groups to patrol the South China Sea.

Also, important to note in this realm is the role of militaries other than those of the United States or China. South Korea is a powerful player itself while Japan's continuing attempts at reforming its armed forces to a more offensive doctrine demonstrates the relative instability of the region in general. Moreover, Japan clearly possesses a wariness of China's intentions, partially stemming from the presumed lack of commitment to regional protection from the United States. South Korea's army, built to stop North Korean aggression, is fundamentally different than any focus on a potential Chinese invasion. Japan, despite its state-of-the-art logistics and equipment, would likely not be able to withstand a Chinese invasion for long. Other midlevel regional powers such as Vietnam and the Philippines have relatively large and comparatively well-equipped militaries and have also expressed anger at perceived Chinese aggression, while simultaneously voicing concern at their own inability to halt such provocations. While it is not likely that large-scale military hostilities will commence between the states in question, the mere fact that China's military capacity is available and much more intimidating than before could and does play a role in rational calculations of regional actors. Again, there is an economic component to this, as military aggression would spell disaster for the rising economic integration within the region. Trade would likely decline steeply as regional suspicions, and outright hostilities arose. As stated before, however, the threat of China's military might be already enough to affect all interactions between China, the United States, and others.

Washington Consensus Versus Beijing Consensus

Central to the narrative of China and the U.S. is the role of specific types of institutions like military cooperation agreements, FDI facilitators, and those which focus on enhancing economic integration. It is essential to analyze them and their instruments in the process of conducting foreign policy, trade, and international communication. Past American supremacy has been enshrined through its active role in the "Washington Consensus," which required a standard set of economic reform, consistent with U.S. goals of shaping developing countries through policies such as opening markets for investment and competition and reducing government subsidies. After the Global Financial Crisis of 2008, however, there was a noticeable tone shift in how states adopted or otherwise implemented these institutional guidelines. It could be argued that, in fact, China was able to leverage this discrediting of the U.S. model, along with its own economic development and consolidation of effective authority

within the country, to essentially develop its own system for development, the so-called “Beijing Consensus.” Whether this consensus does in fact exist is somewhat irrelevant in this case, as the suggestion that it might only further illustrate the decline in prestige of the American method. Regardless, the consolidation of a set of principles in the ideational realm can be utilized by China to spread its own method of economic development to the region in general.²⁵

As long as these dueling consensus exist, there will be coalitions of institutions which shall formulate policy and interactions within the spheres of influence of each. For the United States, the Washington Consensus has variously included monetary and fiscal organizations such as the International Monetary Fund (IMF) and World Bank, and trade pacts such as NAFTA and the former TPP. For the United States, in particular, military alliances with NATO, and mutual defense treaties with South Korea, Japan, and the Philippines also fall into this category. Most recently, China’s attempt at creating their own set of institutions has yielded the RCEP, Shanghai Cooperation Organization, Asian Infrastructure Investment Bank among others. These represent the continual effort on the part of the Chinese to craft a system more suitable to their worldview and will likely, therefore, come into conflict with American-led institutions as they expand and interact. Instead of a regular state conflict through diplomatic and military vectors, it is somewhat likely then that conflict now and into the future will be informed by the stakeholder interests and demands of the international networks present within the consensus. Whereas traditional globalization was concerned with opening up of barriers and promotion of democracy, now these institutions are ever more focused on limited multilateralism and promotion of state power through the institution itself. While state conflict is the motivation, the battles are ever more being fought through the purview of intergovernmental coalitions.

Korea and Japan

For the United States, separate alliances with Japan and South Korea create a strong foundation of American foreign policy. It will be essential to preserve the strength of these relationships through a tripartite alliance, especially as China becomes ever more ambitious and outward-looking. While Japan, in particular, is not likely to soon embrace China as an ally, the United States’ unreliability in the security and economic sectors has made China a more attractive economic partner.²⁶ South Korea, on the other hand, may be more likely to integrate into China’s sphere. Already the two are heavily invested in one

²⁵ Mark Beeson and Fujian Li, “What Consensus? Geopolitics and Policy Paradigms in China and the United States,” *International Affairs* 91 no. 1 (January 1, 2015): 103, <https://doi.org/10.1111/1468-2346.12188>.

²⁶ Putz, “The Art of the Balance: Japan, China and the United States.”

another, especially China into South Korea. Also, South Korea's detente with North Korea only spells good news for Chinese leadership wary of instability on the Korean Peninsula.

Essential for the U.S. in the future will be an effective strategy to counter the developing "Beijing Consensus," on the part of South Korea and Japan. It is imperative that the U.S. maintains friendly relations with these two and seeks to integrate both further into the U.S. orbit. For such advanced economies, perhaps the most effective vector for further integration is through trade. While the U.S. has the KORUS FTA with South Korea, it still does not have a similar arrangement with Japan. It would be advantageous for the United States then, to focus on implementing a trilateral free trade deal between the three states. This would send a strong message to China that their system is not compatible as it currently stands with traditional American allies.

Also, ever complicating U.S. interests in the region is the tension on the Korean peninsula itself. The North Korean regime as it stands poses a threat to stability within the region and complicates the relations between all regional countries and the U.S. Continued Chinese support for the North Koreans means that military partnerships between the U.S. and South Korea become inexorably tied to tensions on the peninsula itself. For China, the inability of the U.S. to consolidate an effective monopoly on military power projection on the peninsula is worth the chaos that the North Korean regime causes.

If there are problems with South Korea and Japan, on the other hand, the United States may use its immense influence over these countries through military leverage in order to bring them back into line. Similar to the same type of leverage used against Japan during its own period of economic competition with the United States, the U.S. can threaten punitive action, such as pulling troops from their soil. The U.S. must be aware that such action while serving to show continued American influence in the region, may also have the concurrent effect of pushing these two countries into China's orbit, so this must be done carefully.

Important to note as well as the lack of clear consensus regarding the aims and methods of the TPP. While the TPP is an important arrangement for opening up trade in the region, it is also possible that the pact is unnecessarily combative towards China. The explicit exclusion of China and the effective encircling of the country lends credence to Chinese beliefs in American arrogance. While again it is likely that potential continued U.S. dominance will require a slowdown in the growth of Chinese power, it would not help the situation to marginalize the country completely from international pacts which directly or indirectly involve them. The eventual aim, then, is to try to integrate China into the prevailing world system, with the understanding that the context has changed substantially in the past couple of decades, and that a presumed Chinese threat will likely not subside without some sort of struggle between the U.S. and China.

Conclusion

The topics broached above illustrated the complex nature of the relationship between China, the U.S., and the other countries in the region. Situations like these are multifaceted and require a comprehensive and thoughtful approach in order to implement long-lasting solutions. While China's rise is something to be wary of, it also does not benefit the continued success of the United States to use unnecessary energy on strategies that don't work or cause more harm later.

Understanding the context of the current relations between a rising China and the United States is vital for comprehending U.S. relations with the Asia-Pacific region as a whole. Therefore, policy in the future cannot be done without regard for the region, but especially without conceiving China as a power which will want to dictate the future of the region for their own benefit as well.

THE RISE OF CHINA AND ITS TRADE RELATIONSHIP WITH THE U.S.

Angela Wong

Introduction

The election of President Trump marked a shift in U.S. government trade policies with China. While the U.S. deficit with China has been a previous point for concern, the Trump administration took action by implementing tariffs, hindering the free flow of imports from China into the U.S. These tariffs have resulted in increasing prices of imported goods, such as steel, as well as retaliatory tariffs from China on U.S. goods. While the trade war has affected large portions of the populace, tariffs are an important tool for pressuring the Chinese government to discontinue unfair business practices, with the hopes of reducing the trade deficit and improving China-U.S. relations overall. This section of the report will provide policy recommendations through the analysis of the U.S.-China history and current diplomatic relations, followed by chapters on high-technology and cybersecurity.

Leading up to the Trade Wars

China's Economic Background

After the reversal of Maoist economic policies in 1978, small size township and village enterprises have expanded and immensely contributed to China's rapid economic growth. Before the global financial crisis, the Chinese economy appeared unstoppable with annual GDP growth of 13%.²⁷ The sustained economic growth had effectively lifted 800 million individuals out of poverty.²⁸ However, the global financial crisis decreased growth to 6.8%. While the initial impact of the crisis appeared to be devastating, China emerged relatively unscathed due to its closed financial system and governments stimulus packages.²⁹ The economy seemed to have recovered although it is burdened by a sharp decline in exports and a rise in bank loans.

As mentioned above, the Chinese economy has slowed down over the past few years. In response, the Chinese government took upon itself to stimulate the economy and thereby protect it from economic problems overseas. As such, the Chinese government invests vast sums of money into

²⁷ Karishma Vaswani, "How The Crisis Accelerated the Rise of China," *BBC News*, last modified 2018, <https://www.bbc.com/news/business-45493147>.

²⁸ "China Lifting 800 Million People Out of Poverty Is Historic: World Bank," *Business Standard News*, last modified 2017, https://www.business-standard.com/article/international/china-lifting-800-million-people-out-of-poverty-is-historic-world-bank-117101300027_1.html.

²⁹ Vaswani, "How The Crisis Accelerated the Rise of China".

specific industries such as housing, social security, and infrastructure.³⁰ These investments have helped maintain the financial status of the country as it struggles to maintain the bulging middle class that has benefited from the aforementioned rapid industrialization that began in the 1970s. The Chinese government has also invested huge sums in all of its major industries, including steel, automobiles, telecommunications equipment, and semiconductors. Many of the leading firms in these industries are state-owned enterprises. The success of some of these leading firms, such as ZTE and Huawei, are behind the current trade war between the U.S. and China. China's steel companies now produce most of the world's steel. The U.S. trade deficit with China was \$375 billion in 2017, and the trade deficit exists because the U.S. exports to China were only \$130 billion while imports from China were \$506 billion.³¹

U.S.-China Trade History

Major modern trade between China and the U.S. can be traced back to April 1971 via the Ping-Pong Diplomacy initiative.³² These diplomatic relations led by Henry Kissinger were the first public signs of ties between the two countries. This visit by Kissinger laid the required foundations for bilateral trade between the two countries, which were curtailed by the Korean War. The frozen relations between the two countries began to thaw, as the U.S. trade embargoes loosened, sparking the restart of bilateral trade between the two countries.

This was followed by Nixon's visit to China in 1972 and the signing of the Shanghai Communique that sought to improve relations between the two countries.³³ By 1979, China and its counterpart formally established relations, and a three-year U.S.-China trade agreement was signed which awarded both sides 'most favored nation' status.³⁴

In 1980, the first special economic zone was formed in China. This commercial zone offered U.S. companies preferential treatment.³⁵ Furthermore, in 1984, President Ronald Reagan visited Beijing and signed an agreement to eliminate dual taxation between the two countries.

While trade has immensely increased between the two countries, there have been various trade issues that have been detrimental to their relations. The first significant issue was sanctions imposed on

³⁰ Seth Kaplan, "Development with Chinese Characteristics," *The American Interest*, accessed February 02, 2019, <https://www.the-american-interest.com/2018/01/03/development-chinese-characteristics/>.

³¹ Kimberly Amadeo, "US Trade Deficit with China and Why It's So High", *The Balance*, Last modified 2019, <https://www.thebalance.com/u-s-china-trade-deficit-causes-effects-and-solutions-3306277>.

³² Timeline: U.S. Relations with China 1949—2018," Council on Foreign Relations, last modified 2018, <https://www.cfr.org/timeline/us-relations-china>.

³³ "Timeline: U.S. Relations with China 1949—2018."

³⁴ "U.S.-China Trade Timeline: 1784-2008," Stratfor, accessed February 02, 2019, <https://worldview.stratfor.com/article/us-china-trade-timeline-1784-2008>.

³⁵ "U.S.-China Trade Timeline: 1784-2008."

China in 1989.³⁶ These sanctions were placed as a result of the Tiananmen Square incident, where the Chinese Communist Government killed numerous protesters. The trade ban that the U.S. set on China included rescinding financing and a ban on the police and military equipment exports.³⁷

In 1992, the first intellectual property rights dispute between the two countries was launched. Chinese authorities discovered that Shenzhen Reflective Material Institute had copied around 700,000 copies of the Microsoft hologram.³⁸ The Shenzhen Institute was found guilty under trade infringement laws but was fined a minor sum of about \$250.³⁹ This laid the foundation for the Chinese infringement actions that the Trump administration has disavowed due to the mild punishments that Chinese companies face.

In 2000, normalization of trade was formalized as President Bill Clinton authorized the U.S.-China Relations Act of 2000.⁴⁰ The trade between the two countries rose significantly from \$5 billion in 1980 to \$231 billion in 2004. In 2001, China joined the World Trade Organization (WTO) after it was awarded the most favored nation status by the United States. As part of the conditions set for joining the WTO China agreed to open up its internal market. However, China has ignored various WTO requirements and instead has restricted global companies such as Google from operating, and illegally obtaining intellectual property from foreign companies. In 2006, China became the United States' second biggest trading partner after Canada, surpassing Mexico. The increased trade between the U.S. and China resulted in a considerable trade imbalance, a situation that President Trump tried to remedy with the introduction of tariffs.

In 2004, the U.S. filed a WTO complaint against China. This kicked off a myriad of conflicts as both countries used the international body to give injunctions against each other. The first significant attempt to make legislation aimed at controlling the flow of goods from China was put forth in 2005 by Senators Lindsay Graham and Charles Schumer. The bill threatened to impose 27.5% tariffs on imports from China.⁴¹ Also, in July of the same year, U.S. regulators blocked a takeover bid of Unocal Corporation

³⁶ Michael Caster, "The 'Tiananmen Sanctions' Should be Strengthened, not Lifted," *CNN News*, last modified 2018, <https://edition.cnn.com/2018/06/04/opinions/tiananmen-sanctions-us-china-trade-caster-intl/index.html>.

³⁷ Caster, "The Tiananmen Sanctions Should be Strengthened, not Lifted."

³⁸ Lawrence Sullivan and Robert Paarlberg, *Historical Dictionary of Chinese Foreign Affairs*, Rowman & Littlefield, 2018.

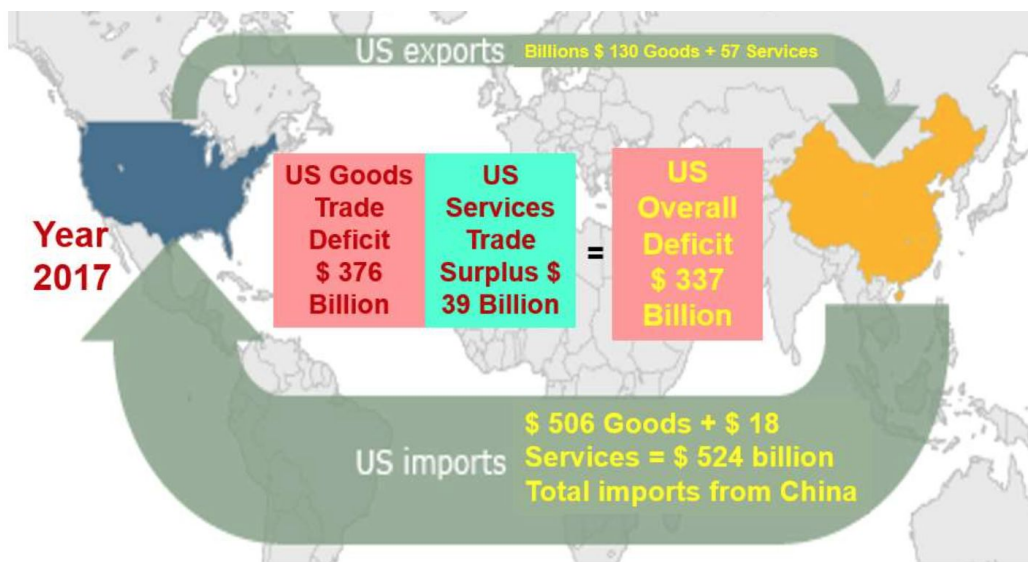
³⁹ Sullivan and Paarlberg, *Historical Dictionary of Chinese Foreign Affairs*.

⁴⁰ "Timeline: U.S. Relations with China 1949—2018."

⁴¹ Douglas Irwin, *Clashing Over Commerce: A History of US Trade Policy* (Chicago: University of Chicago Press, 2017).

by China National Offshore Oil Corporation.⁴² In 2007, the U.S. complained to the WTO that the Chinese government was unfairly promoting exports through the use of subsidies.

In 2008, China became the biggest lender to the United States, and by 2012, the trade imbalance between the two countries was enormous and started to spark trade tensions as the deficit rose from \$273.1 billion in 2010 to \$295.5 billion in 2011.⁴³ The U.S. and other parties then requested the WTO to intervene due to unfair trade practices such as China’s intentional limitations on exporting rare earth metals to certain nations, including Japan.⁴⁴ Several significant problems have been created between China and the U.S. as a result of this, in sectors such as cybersecurity, high-tech, military, and AI. More will be discussed in the next two Chapters.



Source: Contractor, Farok. "Ten Quick Facts About US Trade: Deficits and Discords."

Trade War Between the U.S. and China

The U.S. and China are locked in a heated trade war, resulting in tariffs and trade barriers being imposed on each other. Before becoming President, Donald Trump consistently complained of the lopsided trade imbalance between the two countries. In 2017, the U.S. launched an investigation on Chinese trade policies and in February 2018, President Trump imposed the first round of tariffs in the form of a 30% tariff on solar panels and washing machines. The Chinese thought the tariff increase was unfair and lodged a complaint to the World Trade Organization.

⁴² Eric Ellis, "Mainland Master Stirs Up Hong Kong Market," *Euromoney*, accessed February 06 2019, <https://www.euromoney.com/article/b18t62j8dchkf6/mainland-master-stirs-up-hong-kong-market>.

⁴³ Ellis, "Hong Kong Market."

⁴⁴ Ellis, "Hong Kong Market."

In March 2018, Donald Trump imposed a 10% tariff on aluminum and 25% tariff on steel imports.⁴⁵ This tariff disproportionately affected China who is a significant exporter of aluminum and steel to the U.S. The tariffs have had mixed effects on the U.S. economy. Local companies that relied on imported steel and aluminum felt the impact of the tariff as they were forced to pay higher prices, resulting in the layoff of employees. Conversely, some aluminum and steel mills that had been closed due to the low cost of imports reopened.⁴⁶ These mills reemployed hundreds of jobless workers,⁴⁷ showing the dynamic nature of tariffs and how they affect various industries differently.

Furthermore, the U.S. listed over 1300 items as eligible to be included within the tariffs. Some of these items included batteries, medical devices, and aircraft parts. On April 2, 2018, China retaliated and imposed taxes on 128 products including pork, fruit, and other items.⁴⁸ China placed a 25% tariff on soybeans and 15% tariff on fruits and nuts.⁴⁹

In June, the U.S. stated that it would impose a 25% tariff on Chinese items worth \$50 billion, with the tariff on Chinese items worth \$34 billion slated to commence immediately. China stated that it would retaliate and three days later the U.S. reported that it would impose a 10% tariff on items that worth \$200 billion if China acted on further tariff retaliation.⁵⁰ On July 6th, the tariffs of \$34 billion worth products came to fruition, and the Chinese matched the duties imposed. Four days later, the U.S. published a list of items worth \$200 billion that would be included in the 10% tariff.⁵¹ China stated that they would retaliate with tariffs on American items worth \$60 billion.

⁴⁵ "US-China Trade War: A Timeline from First Tariffs to The 90-Day Truce," *South China Morning Post*, accessed February 09, 2018, <https://www.scmp.com/news/china/diplomacy/article/2179505/us-china-trade-war-timeline-first-tariffs-90-day-truce>.

⁴⁶ Aamer Madhani, "U.S. Steel to Reopen Dormant Illinois Plant, Credits Proposed Trump Tariffs", *USA Today*, accessed February 09, 2019, <https://www.usatoday.com/story/money/2018/03/07/u-s-steel-says-reopen-illinois-steel-plant-trump-tariffs/403064002/>.

⁴⁷ Berkeley Jr., "US Steel CEO: We're Reopening an Idled Plant and Bringing Back 500 Jobs Due to Trump Tariffs," *CNBC*, accessed February 09, 2019, <https://www.cnbc.com/2018/03/07/us-steel-reopening-plant-and-bringing-back-jobs-ceo-on-trump-tariffs.html>.

⁴⁸ Emily Price, "All 128 US Products China Is Enacting Tariffs On," *Fortune*, April 02, 2018, <http://fortune.com/2018/04/02/china-tariffs-128-us-products/>.

⁴⁹ Price, "US Products China is Enacting Tariffs On."

⁵⁰ Han Wei, "China Strikes Back with Second Tranche Of Tariffs," *Caixin Global*, August 08, 2018, <https://www.caixinglobal.com/2018-08-08/china-strikes-back-with-second-tranche-of-tariffs-101313018.html>.

⁵¹ Han Wei, et al., "Update: U.S. Names Products Targeted By \$200 Billion In New Tariffs," *Caixin Global*, accessed February 16, 2019, <https://www.caixinglobal.com/2018-07-11/quick-take-us-threatens-tariffs-on-additional-200-billion-in-china-goods-101304428.html>.

In August, the U.S. published a list of 279 items worth \$16 billion that would be subject to 25% tariffs which the Chinese equally matched as a countermeasure.⁵² However, the trade war cooled as low-level talks were held to prevent the escalation of the trade wars. Unfortunately, these talks failed, and the 16% tariffs took effect.

The Scramble Over the Asia-Pacific: China and the U.S.

Chinese Attempts for Market Expansion

China has made serious attempts to expand its market throughout the rest of the geopolitical sphere through the Belt and Road Initiative (BRI), strengthening trade and infrastructure of 65 Eurasian countries,⁵³ and through the Regional Comprehensive Economic Partnership (RCEP), an ambitious Chinese-led trade group affecting major Asia-Pacific powers, which is a close substitute to the TPP but without U.S. influence. The BRI initiative will improve critical infrastructure such as cross-border transportation, which will improve connectivity and reduce trade costs. China's primary BRI goal is reducing the trade barriers for entry and enabling Chinese manufacturers to safeguard the long-term sustainability of exports,⁵⁴ making them the world's most extensive commercial empire. This reflects a long-term strategy for exploring new markets for Chinese exports in the wake of shrinking Western markets. Other than expanding its influence in Eurasia with the BRI, China has been using the withdrawal of the United States from the TPP as an opportunity to establish the RCEP to close the vacuum in the Asia-Pacific without U.S. influence. Overall, China and other BRIC nations have expanded China's influence, resulting in excluding U.S. public and private sectors from this region. It is estimated that China spends \$40 billion per year through its Development Finance Institutions (DFIs) like the Export-Import Bank of China, the Beijing-based Asia Infrastructure Investments Fund, and the Silk Road Fund.⁵⁵

American Attempts for Market Expansion

To counter these new initiatives led by China, the U.S. launched the International Development Finance Corporation (IDFC) in 2018. This agency functions to counter the Chinese BRI, as it finances infrastructure projects in emerging markets. The IDFC strives to counter Chinese influence in countries such as Kenya where it is involved in the Lamu Port, South Sudan, Ethiopia Transport Corridor (LAPSSET)

⁵² Niv Elis, "Trump to Hit China With \$16B In Tariffs On Aug. 23," *The Hill*, accessed February 09, 2019, <https://thehill.com/policy/finance/400791-trump-to-hit-china-with-16b-in-tariffs-on-aug-23>.

⁵³ "Belt and Road Initiative," World Bank, last modified 2018, <https://www.worldbank.org/en/topic/regional-integration/brief/belt-and-road-initiative>.

⁵⁴ "Belt and Road Initiative," World Bank.

⁵⁵ Mercy Kuo, "The U.S. International Development Finance Corporation and China," *The Diplomat*, October 25, 2018, <https://thediplomat.com/2018/10/the-us-international-development-finance-corporation-and-china/>.

as a counter to the modern Standard Gauge railway that is financed by China. Additionally, both the U.S. and China are scrambling to capture new markets in Vietnam and Malaysia. China had a hold on the Vietnamese market, but Vietnam has started to reduce its reliance on the Chinese market and has begun to ratify new trade deals with Western countries.⁵⁶ This gives its export-dependent market more room to mitigate the trade wars. Such moves have excited the U.S. which sees Vietnam as a viable market for U.S. products.

Perspectives and Aims of the Trade War: U.S., China, and President Xi

United States

The aims of this trade war are dynamic, with each side trying to gain an advantage. From the onset, the U.S. complained about the lopsided trade imbalance. The U.S. imports more goods than it exports to China, creating the enormous trade deficit that the U.S. thinks is unfair. Additionally, the U.S. complained that China often uses predatory tactics that prevent U.S. products from entering the market. Moreover, China habitually depressed its currency, making it expensive to import products while making exportation of products highly profitable.⁵⁷ The tariffs are also seen to counter Chinese government subsidies to SOEs, enabling them to artificially lower the prices of their commodities which makes them more competitive.⁵⁸ Therefore, these products are sold at a lower cost than U.S. manufactured goods, which puts U.S. firms at a disadvantage on the international market.

The U.S. has complained about intellectual property theft and forced provision of technology to Chinese firms. The Chinese have also been accused of hacking private and public entities in the U.S. Thus, the United States is concerned by China's effort to acquire advanced U.S. technology and to sell Chinese technology. This is shown by the U.S. decision to prevent companies such as Huawei from investing in the U.S. telecom sector. Lastly, the Trump administration is fulfilling its campaign promise to bring back manufacturing jobs to the U.S. as a way of boosting local economies. For example, placing

⁵⁶ Keegan Elmer, "Vietnam Becomes Seventh Nation to Adopt New Trans-Pacific Partnership," *South China Morning Post*, accessed February 09, 2019, <https://www.scmp.com/news/china/diplomacy/article/2172939/vietnam-steers-between-us-and-china-ratifying-trade-deal>.

⁵⁷ Charles Wallace, "China's Currency Manipulation Is a Response to Trump's Tariffs," *Forbes*, accessed February 16, 2019, <https://www.forbes.com/sites/charleswallace1/2018/07/21/chinas-currency-manipulation-is-a-response-to-trump-s-tariffs/>.

⁵⁸ Mike Bless, "WTO Case Sheds Light on China's Illegal Practices," *The Hill*, accessed February 16, 2019, <https://thehill.com/blogs/pundits-blog/international/314341-wto-case-sheds-light-on-chinas-illegal-practices>.

tariffs on steel and aluminum has led to the reopening of smelting facilities that were previously closed.

59

China

The Chinese are against the rising tariffs for three main reasons. First, the Chinese enjoy the enormous trade imbalance, as it means that more money flows into China; thus, trade is positive for the economy. This has been highlighted by the trade war, as the number of exports from China to the U.S. hit a 28-month low after Trump imposed tariffs.⁶⁰ For China, this surplus is beneficial for their economy enabling financing, for example, of infrastructure development.

Second, the Chinese favor the imbalance since it ensures its well-protected industries can sell huge amounts of products at home and abroad. China highly protects its industries from foreign products. Opening up China will result in more imports which will put pressure on China's local economies. This type of protectionist measure is effective in limiting the impact of globalization on local markets. A decline in exports will hurt various industries such as manufacturing which employ a lot of people. This may increase the unemployment rate in China, as it is highly reliant on exports. This would ultimately damage the Chinese economy and create huge political problems for President Xi Jinping.

Third, exports to the U.S. are a significant part of net Chinese exports. Tariffs on goods sold to the U.S. will depress their exports, which will make it harder to sustain the growing middle class. The legitimacy of the Communist party is primarily based on the economic growth that characterized the post-Mao era. The government worries that the tariff war may exhaust its diminishing export market in the U.S., which may lead to a weakening of its economy. China, in retaliation, has been forced to impose tariffs on imported food items from the U.S. Currently, China heavily imports U.S. agriculture products, therefore an increase of tariffs on might interfere with the Chinese food supply. This forecast of a diminishing Western market was responsible for the establishment of the Belt and Road Initiative. The primary aim of the funds is reducing the barrier to entry for Chinese exports to countries surrounding China, safeguarding the long-term sustainability of Chinese exports.

Mostly, the Chinese are opposed to the tariffs since they are more likely to get hurt than the Americans since they are net exporters. However, the U.S. public will pay higher prices, and over the long run, U.S. firms may be forced to look for alternative markets.

Chinese Government's Response: President Xi Jinping

⁵⁹ Berkeley Jr., "US Steel."

⁶⁰ Ken Roberts, "Tariff War Update: Record Chinese Imports, Exports At 28-Month Low," *Forbes*, accessed February 16, 2019, <https://www.forbes.com/sites/kenroberts/2018/12/10/tariff-war-update-record-chinese-imports-exports-at-28-month-low/>.

In November, the Chinese president stated that he was ready to import more products from overseas.⁶¹ This was in response to accusations by President Donald Trump that Chinese policies prevent importation of goods into the country. President Xi Jinping said that China would import goods and services worth \$30 trillion and \$10 trillion respectively, in the next 15 years.⁶² He also stated that he would open up the Chinese market and support global free trade thereby opening up China to the world.⁶³ As of the writing of this report, the U.S. and China are still in negotiations to resolve the trade war.

Implications for Opposing Perspectives

The two different viewpoints of China and the U.S. are problematic because they hinder attempts to compromise. For example, the U.S. is determined to force China to open up its market for American goods, but on the other hand, China is concerned that removing the trade barriers and ceding control over its currency will make the internal economy less profitable. As such, reaching a compromise on these trade issues is very difficult. Additionally, China views that the tariffs on its exports to the U.S. are prohibitive, but the U.S. sees the tariffs as a way of balancing trade between the two countries. The U.S. viewpoint is justifiable since Chinese goods are taxed less and have easy access to the U.S. economy as compared to American products that attempt to enter the Chinese market.

Conclusion

The trade wars between China and the U.S. have been brought about by the trade deficit, Chinese pressures on U.S. firms to transfer technology for market access, Chinese hacking of U.S. government agencies and businesses, and various attempts to steal critical intellectual property from U.S. companies. While in practice, the tariffs may be harmful to U.S. companies and consumers and may not reduce the U.S. deficit, they can be used as an effective short-term tool to negotiate better market access and a more reciprocal trade relationship. There are other ways of reducing the deficit, but the Chinese government rarely abides by international treaties. Thus, the U.S. should continue imposing tariffs until the Chinese government agrees to change its predatory trade practices in ways that are easily verifiable; for example, China should open up its market and freely allow the importation of products. Secondly, the Chinese government should be barred from offering subsidies to manufacturers

⁶¹ "China's Xi Promises to Lower Tariffs, Broaden Market Access, And Import More," *CNBC*, accessed February 16, 2019, <https://www.cnbc.com/2018/11/05/chinas-xi-promises-to-lower-tariffs-broaden-market-access-and-import-more.html>.

⁶² "China's Xi Promise," *CNBC*.

⁶³ "China's Xi Promise," *CNBC*.

as it enables them to sell their products cheaply, which undermines genuine competition. The tariff war is a vital negotiation tool that the U.S. wishes to utilize to level the playing field between the two countries as it recognizes that Chinese exports heavily rely on the U.S. market. While the tariffs are painful for the consumer, they are advantageous in the short-term as a negotiation tool.

Policy Recommendations

- The United States should continue tariffs in the short-term until the Chinese government agrees to change predatory trade practices, such as subsidizing key industries and currency manipulation, and encourage further deregulation of Chinese market access for U.S. companies, promoting free trade between the two countries. However, in the long-run, tariffs are not beneficial to the economies of China or the U.S.; therefore the United States should discontinue tariffs if most of these expectations are met.
- The U.S. should take further measures to prevent IP and technology theft, counterfeiting foreign products, and Chinese hacking of private and public entities, to create conducive environments for trade.
- The U.S. and China should continue to use the WTO as a forum for dispute resolution. The U.S. should implore the WTO to hold China accountable for basic membership rules to open their markets, discontinue government subsidies, and end forced technology transfers.
- The U.S., and the President specifically, should conduct negotiations and complaints with China privately, instead of publicly and over social media. Having formal diplomatic negotiations face-to-face would be beneficial to U.S.-Chinese relations and show the President is committed to finding trade solutions.

CHINESE INVESTMENT IN HIGH TECHNOLOGY

Esther Lee

Introduction

Over the past decade, China has emerged as one of the most significant manufacturing phenomena since the beginning of the industrial revolution in the eighteenth century. By the end of 2012, China officially became a global leader in manufacturing operations and the second largest economic power in the world.⁶⁴ Now, China is seeking to rise from “the world’s factory” to “world-class industrialized power.”⁶⁵ By 2004, China’s exports of high-tech goods increased steadily, exceeding the value of U.S. exports and creating the trade deficits the Trump administration is highly critical of.⁶⁶ Additionally, as mentioned earlier in the report, President Trump’s criticism of China extends to the *Made in China 2025* program, a fourth industrial revolution policy with the goal of transitioning China’s economy towards high-tech industries.⁶⁷

Made in China 2025 was originally issued by Chinese Premier Li Keqiang in May 2015. This policy seeks to make China dominant power in global high-tech manufacturing. *Made in China 2025* “aims to use government subsidies, mobilize state-owned enterprises, and pursue intellectual property acquisition... to surpass Western powers.”⁶⁸ The strategy closely follows Germany’s Industry 4.0 Development plan, aiming to become a dominant economic powerhouse by developing high-tech industries. Policies like *Made in China 2025* that aims to make China a dominant power in high-technology, creates concern for the U.S. that the industrial policy will challenge the economic composition of the current U.S.-led world order.⁶⁹

⁶⁴ Ling Li, “China’s Manufacturing Locus in 2025: With a Comparison of ‘Made-in-China 2025’ and ‘Industry 4.0,’” *Technological Forecasting and Social Change* 135 (October 1, 2018): 66–74, <https://doi.org/10.1016/j.techfore.2017.05.028>.

⁶⁵ Li, “China’s Manufacturing Locus in 2025.”

⁶⁶ Alice Wu et al., “Why ‘Made in China 2025’ Triggered the Wrath of President Trump.” *South China Morning Post*, accessed January 31, 2019, <https://multimedia.scmp.com/news/china/article/made-in-china-2025/index.html?src=follow-chapter>.

⁶⁷ Kristen Hopewell, “What Is ‘Made in China 2025’ — and Why Is It a Threat to Trump’s Trade Goals?,” *The Washington Post*, May 3, 2018, https://www.washingtonpost.com/news/monkey-cage/wp/2018/05/03/what-is-made-in-china-2025-and-why-is-it-a-threat-to-trumps-trade-goals/?utm_term=.bbc74434d77b.

⁶⁸ James McBride, “Is ‘Made in China 2025’ a Threat to Global Trade?,” Council on Foreign Relations, accessed February 14, 2019, <https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade>.

⁶⁹ Jost Wubbeke et al., “*Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries*,” Mercator Institute for China Studies (MERICS), December 2016, https://www.merics.org/sites/default/files/2017-09/MPOC_No.2_MadeinChina2025.pdf.

Another essential strategy China established to accomplish efficient and rapid growth is coercing foreign companies into joint ventures. Under this arrangement, American manufacturers are able to gain valuable access to the rapidly expanding Chinese markets. Meanwhile, Chinese companies benefit from exposure to foreign technology. Due to extreme pressure on American companies from the Chinese government, “the joint venture policy has raised questions of whether Chinese firms have unjustly appropriated certain technologies and intellectual property from American partners, as tensions over trade escalated between the United States and China in recent years.”⁷⁰

Consequently, Chinese industrial policies are already affecting China’s geopolitical relationship with the United States. In the past, the U.S. has been very slow to react to this technological threat, in part because it was occupied with issues in the Middle East. The United States is now well aware that China’s technological advancement is leading to the development of new military technology and is likely to pose a security threat in the near future, if not already. Based on a belief that Chinese policies are unfair, President Trump has implemented tariffs to block Chinese acquisition of U.S. firms.⁷¹ However, levying tariffs is not the only strategy to eliminate Chinese non-tariff barriers and to protect U.S. intellectual property, though tariffs have been effective in forcing China to the negotiation table. Therefore, this Chapter explores how *Made in China 2025*, and joint ventures have created harmful technology transfers, resulting in negative implications for the U.S. economy and national security, and will suggest alternative policy options.

Made in China 2025

As mentioned previously, *Made in China 2025* is the Chinese government’s industrial development ten-year master plan. The plan signifies China's intention to launch an industrial transformation from labor-intensive production to knowledge-intensive manufacturing. Further, the plan portrays the Chinese government’s ambition to achieve a major economic breakthrough such as “improving the quality of products made in China, creating China's own brands, building a solid manufacturing capability by developing cutting-edge advanced technologies, researching new materials, and domestically producing key components of major products.”⁷²

One industry sector the Chinese government is focusing on specifically is semiconductors, which are ultimately central to nearly all electronic products. Therefore, China is aiming to develop a

⁷⁰Michael Greubel, “Joint Ventures in China: Outlook in the Contemporary Political Economy,” May 19, 2018, Accessed February 14, 2019.

⁷¹ McBride, “Is ‘Made in China 2025’ a Threat to Global Trade?”

⁷² Li, “China’s Manufacturing Locus in 2025.”

sophisticated semiconductor industry to increase innovation in other technology sectors. Moreover, chips are a leading source of significant economic growth. For instance, “the U.S. chip industry directly employs about 250,000 people and generates \$164 billion in sales each year.”⁷³ Development of semiconductor factories often leads to the growth of entire sub-industries around them. Furthermore, superiority in the semiconductor sector can help ensure a powerful military since critical portions of the semiconductor industry have specific applications for military use.⁷⁴ The ultimate goal of the Chinese government is to have “40% of mobile phone chips on the Chinese market be produced in China by 2025, as well as 70% of industrial robots and 80% of renewable energy equipment.”⁷⁵ However, Chinese officials have been keeping these plans at an unofficial status, fearing consequences from other countries. This lack of transparency is an issue which will be discussed later in this Chapter.

According to the State Council of the People’s Republic of China, *Made in China 2025* is only the first stage of a Three-Phase grand plan. In Phase One of the policy, China strives to be included in the list of global manufacturing powers, while Phase Two aims to have China reach the medium level in this area in the world and finally in Phase Three, China dreams of being a leading manufacturing power.⁷⁶ Thus, the United States needs to negotiate with China now, as this opportunity will likely disappear once *Made in China 2025* establishes China as a more dominant and independent nation, changing geopolitical relations and the world order. Therefore, it is necessary to pressure China into major changes now, while maintaining a good relationship with other allies.

The push for industrial modernization through *Made in China 2025* creates tremendous demand for high-tech manufacturing products. This jump in demand is attractive for foreign companies who can supply the advanced technologies necessary to manufacture these products, which China currently lacks.⁷⁷ Thus, in the short-term, *Made in China 2025* could mean enormous profits for international firms. The policy has the potential to create opportunities for mutually beneficial investment and to strengthen relationships with Europe and the United States through economic interdependence. Therefore, in theory, global markets should encourage China’s plans, as long as growth is through the established frameworks of international norms such as maintaining open markets and fair competition.⁷⁸

⁷³ Josh Horwitz, “US-China Tech: Why the Semiconductor Is Suddenly at the Heart of US-China Tensions” Quartz, accessed February 14, 2019, <https://qz.com/1335801/us-china-tech-why-the-semiconductor-is-suddenly-at-the-heart-of-us-china-tensions/>.

⁷⁴ Horwitz, “US-China Tech: Why the Semiconductor Is at the Heart of US-China Tensions.”

⁷⁵ Wubbeke, “Made In China 2025.”

⁷⁶ Li, “China’s Manufacturing Locus in 2025.”

⁷⁷ Wubbeke, “Made In China 2025.”

⁷⁸ Wubbeke, “Made In China 2025.”

However, *Made in China 2025* in its current form is not upholding these ideals. Instead, the Chinese government is directly influencing markets to artificially facilitate and improve the competitiveness of Chinese companies over foreign competitors in many of the high-tech sectors targeted within the policy. The main goal of *Made in China 2025* is to eventually create domestic replacements for technologies that are currently foreign-owned.⁷⁹ This will affect not only the United States but also its closest allies, ultimately challenging the world order. Therefore, in order for United States to maintain its power and protect its allies, the U.S. must take aggressive measures using international forums and other tools to address the issues of illegal government subsidies and forced technology transfers.

China also has demonstrated the capacity to experiment with new business models and technologies. The Chinese government often establishes protocol model projects with technologies which are later applied nationwide. For example, in 2015 and 2016, the Ministry of Industry and Information Technology (MIIT) established pilot cities and manufacturing innovation centers for the *Made in China 2025* plan, including Ningbo and other cities in the Pearl River Delta.⁸⁰

Given the rising concern for this policy's potential, it is important to understand the potential weaknesses that *Made in China 2025* faces. Many scholars believe that *Made in China 2025* will probably fail to establish comprehensive technological development on a national scale. The policy is limited by the lack of congruence between political objective and the reality of the Chinese industry. The program is already showing the inefficient allocation of funding and overspending. In addition, "upgrading the production processes might result in job losses among the less skilled workforce because the general Chinese education system is not prepared for training sophisticated technology."⁸¹ As a result, the overarching goal of *Made in China 2025* will most likely not be reached within the intended timeline of the Chinese government.⁸² However, policies such as *Made in China 2025* will lead to Chinese technological development which has the potential to hurt opportunities for U.S. firms in China and abroad.

Another issue of *Made in China 2025* is the vast subsidizing of industrial sectors by the Chinese government. For example, "the National Integrated Circuit Fund received 134 billion CNY (almost \$21

⁷⁹ Wubbeke, "Made in China 2025."

⁸⁰ Hopewell, "What Is 'Made in China 2025' — and Why Is It a Threat to Trump's Trade Goals?"

⁸¹ Wubbeke. "Made in China 2025."

⁸² "China's Tech Industry Is Catching up with Silicon Valley - Chart," *The Economist*, accessed February 7, 2019, <https://www.economist.com/graphic-detail/2018/02/16/chinas-tech-industry-is-catching-up-with-silicon-valley>.

billion USD) to promote industrial growth.”⁸³ These subsidies violate WTO rules against government subsidies to major firms. Additionally, this could devastate countries who are allies with the United States, such as South Korea and Germany, where high-tech sectors constitute a large share of industrial output and exports, and could ultimately affect the current geopolitical balance and the U.S.-led world order.⁸⁴ Although these policies are standard tools for developing countries to “catch up” with the richer, industrialized West, China is now a major economic power and needs to play by the rules of the WTO or be prevented from gaining the benefits of the global free trade regime.

Joint Ventures and Forced Technology Transfers

As mentioned previously, Chinese enterprises and the government perceive technology transfers from abroad as an essential strategy to accelerate technological progress and to achieve ambitious political goals. Moreover, technology transfers are the most efficient way to advance Chinese technological ability to reach the government's economic goals. There are many methods that facilitate these kinds of technology transfers, but this chapter will focus on the most controversial for the U.S., and for U.S. companies in China: forced technology transfers through joint ventures.⁸⁵

Technology sharing and spillover as part of investment is a frequent occurrence with countries all over the world, not just in China. However, the situation with China is different. In many industries, foreign firms have been forced to enter joint ventures and give their Chinese partners access to critical technologies in order to have the investment approved. In addition, a new emerging trend is Chinese firms going abroad with the goal of buying foreign firms that have key technologies. Chinese officials know that China lags behind in critical high-tech sectors and are therefore promoting a strategy of “foreign acquisitions and forced technology transfer agreements.”⁸⁶

At first, joint ventures seemed beneficial to U.S. companies as they were gaining huge profit margins from Chinese government investment and subsidies in the joint venture. However, once China acquires key technologies and takes full control over what were once joint ventures, foreign competitors will face major barriers to Chinese market access. Ultimately the Chinese government will “close off the market for information technology and exclude foreign firms from local subsidy schemes, and the Chinese state will intensively collect digital data.”⁸⁷ As China develops its own industrial sectors,

⁸³ Wubbeke, "Made in China 2025."

⁸⁴ Hopewell, "What Is 'Made in China 2025' — and Why Is It a Threat to Trump's Trade Goals?"

⁸⁵ Wubbeke. "Made in China 2025."

⁸⁶ "Why Does Everyone Hate Made in China 2025?," Council on Foreign Relations, March 28, 2018, accessed February 14, 2019, <https://www.cfr.org/blog/why-does-everyone-hate-made-china-2025>.

⁸⁷ Wubbeke, "Made In China 2025."

discriminatory practices and restrictions of market access in high-tech sectors will intensify.⁸⁸ China's prioritization of political goals over free market competition will ultimately lead to the distortion of global markets.

Consequently, ending forced technological transfers is a primary demand of the United States. While *Made in China 2025* does not explicitly advocate this policy, the U.S. worries that such practices exemplify the Chinese approach to coerce foreign companies into helping Chinese competitors attain global dominance in vital industrial sectors.⁸⁹ President Trump has already showed the U.S. concern for forced technological transfer, implementing tariffs on Chinese goods to block economic policies that rely on "discriminatory treatment of foreign investment, forced technology transfers, intellectual property theft, and cyber espionage already caused."⁹⁰ Furthermore, the Committee on Foreign Investment in the U.S. (CFIUS) has denied Chinese firms from purchasing U.S. companies in sectors with national security implications. Many European countries have also blocked Chinese attempts to purchase key technology firms, exemplifying a heightened global awareness of China's strategy of gaining technology through company acquisitions.⁹¹ The U.S. could raise these critical problems in international forums to address the issues of forced technology transfers and acquisitions.

Case Study: Dismantling a Joint Venture

One instance of the U.S. government successfully dismantling a joint venture is Symantec in 2012. Symantec entered into a joint venture with the Chinese firm Huawei Technologies that develops computer network security products. The partnership was dismantled because "Symantec feared the alliance with the Chinese company would prevent it from obtaining United States government classified information about cyber threats."⁹² When the United States government decided to share more classified cyber-threat information with the private sector, Symantec decided to dismantle. When the Pentagon transferred an information-sharing pilot program called the Joint Cybersecurity Services Pilot to the Department of Homeland Security, "the program was extended beyond those companies to antivirus companies, like Symantec, and network providers."⁹³ Symantec feared that a joint venture with Huawei would create disadvantages when it came to being the recipient of classified threat information.

⁸⁸ Wubbeke, "Made in China 2025."

⁸⁹ Yu Zhou, "U.S. Trade Negotiators Want to End China's Forced Tech Transfers. That Could Backfire," *Washington Post*, accessed January 31, 2019, <https://www.washingtonpost.com/news/monkey-cage/wp/2019/01/28/u-s-trade-negotiators-want-to-end-chinas-forced-tech-transfers-that-could-backfire/>.

⁹⁰ Wubbeke, "Made in China 2025."

⁹¹ Wubbeke. "Made in China 2025."

⁹² Nicole Markoff et al., "Symantec Dissolves Alliance with Huawei of China," *The New York Times*, March 26, 2012, <https://www.nytimes.com/2012/03/27/technology/symantec-dissolves-alliance-with-huawei-of-china.html>.

⁹³ Markoff, "Symantec Dissolves Alliance with Huawei of China"

⁹⁴ This case study can be a model for United States government policies of pressuring American companies in China to be transparent about their involvement with their Chinese partners. Moreover, if U.S. firms do have involvement with the Chinese government that requires more intensive technology transfer, these U.S. policies will give them the option to dismantle their partnerships.

Geopolitical Implications of China Becoming a Global Techno-Superpower

China's efforts to become dominant in advanced technology is now perceived as a national security issue. In 2017, The Pentagon warned that Chinese government investment in products from U.S. firms might also be applied to military technologies such as facial-recognition software, 3D printing, virtual reality systems, and autonomous vehicles.⁹⁵ In other words, if the Chinese government can successfully become dominant in high-tech sectors, China will rise as a powerful rival of the U.S. in geopolitics.⁹⁶

Additionally, in 2018, a White House report warned that China's development has the potential to escalate into a global threat.⁹⁷ For example, over the past year, China has been successfully "rolling out an array of high-tech weapons that some experts say could threaten the global superiority of the United States."⁹⁸ According to Elsa B. Kania, an adjunct fellow at the Center for a New American Security, "the U.S. no longer possesses clear military-technical dominance, and China is rapidly emerging as a would-be superpower in science and technology."⁹⁹

One particular field of technological advancement with potential geopolitical ramifications is the development of artificial intelligence (AI). Recently, there was a performance of a "coordinated deployment of autonomous machines that was successfully demonstrated by a state-owned company which launched 119 drones that performed formations in the sky."¹⁰⁰ With the amount of investments from the Chinese government, it is likely that in the future, China will incorporate effective military applications of artificial intelligence to make better decisions on the battlefield.¹⁰¹

⁹⁴ Markoff, "Symantec Dissolves Alliance with Huawei of China"

⁹⁵ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

⁹⁶ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

⁹⁷ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

⁹⁸ Eric Baculinao, "These Chinese Military Innovations Threaten U.S. Superiority, Experts Say," *NBC News*, accessed February 7, 2019, <https://www.nbcnews.com/news/world/these-chinese-military-innovations-threaten-u-s-superiority-experts-say-n848596>.

⁹⁹ Baculinao, "These Chinese Military Innovations Threaten U.S. Superiority, Experts Say."

¹⁰⁰ Baculinao, "These Chinese Military Innovations Threaten U.S. Superiority, Experts Say."

¹⁰¹ Baculinao, "These Chinese Military Innovations Threaten U.S. Superiority, Experts Say."

Conclusion

Made in China 2025 is in development and there are still opportunities to for the U.S. to negotiate and adjust its direction. For instance, non-tariff barriers are not yet as established in the service sector and the aviation industry. Even though tariffs have been a useful tool to bring China into negotiations, continuation of the United States' protectionist policies, such as imposing tariffs, will only increase other Western states' economic importance for China and vice-versa. Therefore, this Chapter recommends building the leverage to prevent the Chinese government from creating market distortions with subsidization while also maintaining China's openness to investment. Policy of the United States needs to be non-discriminatory and apply equally to state-led investments from all countries to prevent the Chinese government from using protectionist tactics as well.

Transparency of firms involved in joint ventures and technology transfers is an essential goal in these negotiations. The United States government must strategically approach these issues by pressuring American firms in China to also be transparent with the United States government. Since it is harder to implement accountability of the Chinese government, it is more efficient to demand that American firms be honest about their involvement with their Chinese partners. Similar to the Symantec example, if the United States through CFIUS or other government agencies hold U.S. firms accountable for transparency and implement stricter rules on tech companies, firms like Symantec who are not willing to be transparent will pull out from China. Transparency can be increased by establishing mandatory notification and disclosure requirements on what technology the U.S. firm is transferring, and by requiring notification about any Chinese investment in company shares, the size of investment, and the involvement of the Chinese state.¹⁰² Furthermore, increasing restrictions on American firms can also be used as leverage to make the Chinese government be transparent about state-led acquisitions of foreign firms.

Another policy the U.S. could use more effectively is international forums, such as the WTO Agreement on Subsidies and Countervailing Measures (also known as the Subsidies Agreement or the SCM Agreement), to establish multilateral rules on the use of subsidies. The WTO provides mechanisms to challenge the Chinese government's violation of these rules. These rules should be enforceable since China is an official member of WTO. The remedies in such circumstances can include "the withdrawal or modification of a subsidy, or the elimination of a subsidy adverse effects."¹⁰³ In addition, the United States can use the Subsidies Agreement to set forth rules and procedures to govern the application of

¹⁰² Wubbeke, "Made In China 2025."

¹⁰³ Greubel, "Joint Ventures in China."

anti-subsidy or countervailing duty (CVD) measures by WTO members with respect to subsidized imports.¹⁰⁴

Policy Recommendations

- Encouraging the Committee on Foreign Investment in the United States (CFIUS) or other government agencies to intensify requirements and regulations of Chinese investment into U.S. high-tech sectors.
- Use international forums such as the WTO Agreement on Subsidies and Countervailing Measures (also known as the Subsidies Agreement or the SCM Agreement) to establish multilateral rules and procedures on the use of subsidies.
- Use the WTO to present a case against Chinese industrial policies and to strengthen intellectual property protection, labor standards, and safeguards against unfair competition from state-owned enterprises.

¹⁰⁴ Greubel, "Joint Ventures in China."

CYBERSECURITY AND INTELLECTUAL PROPERTY THEFT WITH CHINA

Arjun Bedi

Introduction

Due to vast ideological and political differences, increased value of intellectual property, and rises in protectionist policy, industrial espionage has become an all-too-common tactic supported by the Chinese Communist Government. The Economic Espionage Act of 1996 defines these acts as the “theft of trade secrets that includes the intent to benefit a foreign entity or at least know that the offense will have the result.”¹⁰⁵ Around 42% of U.S.-discovered espionage cases are related to these categories, which is a major portion.¹⁰⁶ Prone primarily to cyber-espionage, U.S. industry has become increasingly vulnerable as China attempts to become more self-sufficient and pursue the aspirations of *Made in China 2025*. As a result, U.S.-China economic relations have suffered immensely, as the mutually threatening trade war continues. Although the U.S. government has taken legislative action and threatens higher tariffs, both have proven to be insufficient and ineffective, as the current volume of industrial espionage attempts shows no signs of deterrence on China’s side. While President Trump has extended the March 1st deadline in the hopes of completing a broad trade agreement with China, it will be very hard to solve this cyber-espionage problem within the current trade talks. To counter this issue, the U.S. should implement expanded measures regulating foreign investment, leverage current diplomatic alliances and institutions, and increase the funding for cybersecurity enforcement and investigation practices. Ideally, these actions would encourage further accountability and responsibility by China, provide an alternative to the threatened tariff increases, and ameliorate the risk of China pursuing industry monopolies. The following sections will further provide the rationale and structure for the policy option recommendations that will be presented at the end of this Chapter.

Understanding China’s Role in Corporate Espionage

In order to address the current threat of espionage, it is important to first analyze China’s motivations, methods for action, and relevant cases that have set the tone for this discussion. Although there are a handful of other countries who pose threats in terms of corporate espionage and cybersecurity, the China case is a special one due to two important realities: the presence of

¹⁰⁵ Nicholas Eftimiades, “Uncovering Chinese Espionage in the U.S.,” *The Diplomat*, November 28, 2018, <https://thediplomat.com/2018/12/the-impact-of-chinese-espionage-on-the-united-states/>.

¹⁰⁶ Eftimiades, “Uncovering Chinese Espionage in the U.S.”

overwhelmingly active government support and involvement, and their major rise present a threat to the world order that was established following World War II.

As mentioned earlier, China is continuing to make strides towards their *Made in China 2025* initiative; this pursues rapid development of major high-technology industries and their manufacturing, aiming to reduce dependence on foreign technology and economic partnerships.¹⁰⁷ As a result, this approach encourages the theft of U.S. intellectual property and government information, as well as that of other nations with strong technology industries, such as Japan and South Korea. A concerning aspect is the presence of various Chinese entities through which the government can conduct these actions with little traceability. Nicholas Eftimiades, a former Homeland Security officer, conducted in-depth research of 274 espionage cases with Chinese involvement. Within this study, around 25% of cases target commercial interests.¹⁰⁸ These actions could be conducted through government agencies, state owned enterprises, private companies, individuals abroad, or even select universities.¹⁰⁹ There are around 150,000 SOEs in China, of which about 50,000 are owned by the central government.¹¹⁰ Due to the presence of these entities which are all somewhat indirectly related to the government, it is difficult to consistently prove their involvement and apply appropriate punishments. Nevertheless, in the Eftimiades study around 20% of cases had a clearly identifiable Chinese government agency or SOE as the customer for illegal exports or trade secrets.¹¹¹ Additionally, Chinese firms are often able to obtain intellectual property through foreign investment policy. Many Chinese firms explicitly suggest that ease of foreign investment will improve if the U.S. firm shares their technology with the Chinese partner.¹¹² This creates a complicated predicament as countless U.S. firms greatly benefit and function through foreign investment partnerships with China, so they cannot easily refrain from agreements that grant Chinese companies major advantages.

Currently, the economic benefits provided by intellectual property theft far outweigh any potential costs of continuing such attempts. It is estimated that around 8% of China's GDP comes from the counterfeiting of creative work, software, goods, and industrial products.¹¹³ This is a conservative projection nonetheless, as it does not account for the capital saved in terms of R&D practices. Additionally, the ease of conducting IP theft or cyber-espionage has increased significantly over the past

¹⁰⁷ McBride, James, "Is 'Made in China 2025' a Threat to Global Trade?"

¹⁰⁸ Eftimiades, "Uncovering Chinese Espionage in the U.S."

¹⁰⁹ Eftimiades, "Uncovering Chinese Espionage in the U.S."

¹¹⁰ State Department Office of Investment Affairs, "China Country Commercial Guide," *Export*, July 25, 2017.

¹¹¹ Eftimiades, "Uncovering Chinese Espionage in the U.S."

¹¹² Farok Contractor, "Ten Quick Facts About US Trade: Deficits and Discords," *Rutgers Business Review*, November 2018, 116

¹¹³ Eftimiades, Nicholas, "The Impact of Chinese Espionage on the United States," *The Diplomat*, December 4, 2018, <https://thediplomat.com/2018/12/the-impact-of-chinese-espionage-on-the-united-states/>.

decade. More and more data are able to fit on smaller devices such as flash drives, making the theft of information much easier to conceal. To supplement this, the existence of the dark web allows for interested parties to conveniently purchase the tools necessary for spying or even hire experienced hackers to do it for them.¹¹⁴ This makes the tools for hacking and IP theft more accessible than ever before, also providing the opportunity for Chinese entities to separate themselves further from the stealing. Lastly, the American Bar Association notes that cyberthieves are using more sophisticated ways to breach company security such as spear-phishing, ransomware, and zero-day malware attack, which are much more difficult to prevent; zero-day malware is aptly titled as there is currently no commercial anti-virus software to eradicate the threat.¹¹⁵ Spear-phishing and ransomware are equally dangerous as they function mainly through the manipulation and misguidance of internet users, often vulnerable and unprepared for these difficult scenarios. This demonstrates the overwhelming amount of options and points of attack to which U.S. firms and the government cannot fully counter on a consistent and rapid basis.

Relevant Espionage Cases

Chinese firms now present a growing threat to American industries and national security in general. ZTE, one of China's largest telecommunications companies and state-owned enterprises, has faced significant criticism and ongoing accusations regarding corruption and IP theft. Last year, they were found guilty for violating U.S. sanctions against Iran and North Korea and lying about their involvement.¹¹⁶ As a result, the U.S. Department of Commerce imposed a ban on U.S. companies selling equipment to them; nevertheless, this ban was lifted only three months later following a \$400 million settlement being paid out by ZTE and an agreement to replace its management team.¹¹⁷ Additionally, President Xi personally asked President Trump to ease pressure on ZTE. This demonstrates the major lobbying capacity possessed by the Chinese government and these companies, making it difficult to deter China's influence in preserving their presence within the U.S. Following the retraction of the ban, the stocks of U.S. companies such as Qualcomm, Intel, Broadcom and Texas Instruments all witnessed significant increases.¹¹⁸ This illustrates the difficulty in approaching the IP theft dilemma, as many U.S.

¹¹⁴ Randolph Kahn, "Economic Espionage in 2017 and Beyond: 10 Shocking Ways they are Stealing your Intellectual Property and Corporate Mojo," *American Bar Association*, September 19, 2018, https://www.americanbar.org/groups/business_law/publications/blt/2017/05/05_kahn/.

¹¹⁵ Kahn, "Economic Espionage in 2017 and Beyond."

¹¹⁶ "U.S. Lifts Ban on ZTE Over Alleged Iran Sanctions Violations," *Radio Free Europe*, July 14, 2018, <https://www.rferl.org/a/us-lifts-ban-zte-imposed-iran-sanctions-violations-/29362478.html>.

¹¹⁷ "U.S. Lifts Ban on ZTE Over Alleged Iran Sanctions Violations," RFE.

¹¹⁸ "U.S. Lifts Ban on ZTE Over Alleged Iran Sanctions Violations," RFE.

companies are so deeply invested in these SOEs and greatly benefit from supplying them equipment and entering joint ventures. Following an investigation by Fairfax Media, there were even more findings stacked against ZTE. They ultimately found case files alleging that ZTE was founded by China's Ministry of Aerospace with the purpose of spying on overseas targets.¹¹⁹ Equally important, it is alleged that ZTE has an entire department dedicated to lobbying and managing bribe payments.¹²⁰ With this information kept in mind, although not concretely confirmed, it is difficult to understand why the U.S. would take the chance with these risk-potential partnerships and organizations.

The United States is not the only country concerned with these risks and controversies. As of 2015, ZTE has been investigated for corruption in ten different countries, including less-resourced countries like Zambia, Myanmar, Liberia and Nigeria.¹²¹ Although this adds to the overwhelming nature of these threats, it also presents a potential for collaboration and solidarity amongst countries victimized or threatened by China's actions. In doing something like this, not only does the U.S. potentially avoid the entire blame or retaliation from China, but China is also more likely to feel pressure and adhere to the desired changes. Collaboration is also important in terms of ameliorating the spread of Chinese influence and power. Australia was reportedly considering contracting either ZTE or Huawei to develop their country's 5G network, a potential risk for their economy and government.¹²² This presented an appropriate opportunity for the U.S. to share its insight and potentially help Australia find an alternative option for network development.

Another unfortunate reality is that China has also been able to use Taiwanese companies for their own interest and information pursuits. One recent case details the collaboration between Fujian Jinhua (Chinese) and United Microelectronics (Taiwanese), who were charged with conspiring to steal from U.S. microchip manufacturer, Micron. The government alleges that one of Micron's former executives recruited two former colleagues to steal trade secrets worth around \$8.75 billion and subsequently transfer it to the Chinese market.¹²³ This demonstrates the significant power possessed by China due to their high amounts of capital and military strength. Now the companies responsible are barred from buying American components for manufacturing. This marks a positive step and a firm response from the United States, but as seen previously it remains inconsistent. Nevertheless, these sanctions ultimately harm United Microelectronics and hinder their chances of future joint ventures; it

¹¹⁹ Tara Chan, "The Very Purpose of the Chinese Tech Company ZTE is to Spy on Other Countries, a Competitor Alleges in New Court Documents," *Business Insider*, June 1, 2018.

¹²⁰ Chan, "The Very Purpose of the Chinese Tech Company."

¹²¹ Chan, "The Very Purpose of the Chinese Tech Company."

¹²² Chan, "The Very Purpose of the Chinese Tech Company."

¹²³ Alan Rappeport, "Justice Department Charges Chinese Company with Espionage," *New York Times*, November 1, 2018, <https://www.nytimes.com/2018/11/01/us/politics/chinese-company-espionage-charges.html>.

may be difficult for them to recuperate from the sanctions as they are a Taiwanese company and would not likely receive assistance from the Chinese government. ZTE was able to ultimately escape similar bans after some settlements and lobbying, so there is no assurance that these restrictions will hold for Jinhua or any future companies who are indicted. These cases speak further to debate whether companies like Huawei, ZTE or Jinhua should be allowed at any capacity to operate or sell their products in the United States or jointly with U.S. companies.

Impacts of Corporate Theft

Over time, the high volume of espionage and corporate theft has created various negative impacts on the United States both economically and strategically. The U.S. economy is continuously experiencing harsh results from espionage, much of which is potentially irreversible. The accumulated estimated costs of IP theft for the U.S. is now between \$225 and \$600 billion, and will continue to rise; China is responsible for about 80% of this estimation.¹²⁴ These statistics demonstrate the considerable economic losses incurred from this vulnerability and grants further justification for the sense of urgency the USTR should have to aggressively address the situation. The attacks on U.S. IP are also indirectly impacting national employment opportunities. Congress estimates that collectively, China's theft of IP has resulted in the loss of 2 million American jobs.¹²⁵ This presents another pressing issue in U.S. economic policy and is one that increasingly concerns U.S. citizens.

Equally important is the indirect impact corporate theft has on the maintenance of beneficial trade relationships. China is currently our largest goods trading partner with \$635.4 billion total traded in 2017, and \$75 billion in services being traded.¹²⁶ This relationship is at risk of diminishing further as IP theft becomes easier and distrust between the U.S. and China increases. As discussed previously, there are now risks associated with foreign investment in China due to the regulations put forth in Chinese policy. Because of this, foreign investment between the U.S. and China must be approached with increased caution and skepticism; future partnerships may also suffer or even be voided entirely. Subsequently, barriers to foreign firms impede the flow of information and limit the pursuit of comparative advantage in industries. The importance of facilitating comparative advantages is one of the pillars of which U.S. trade policy heavily promotes, and these impacts directly threaten our current

¹²⁴ Deanna Okun, "US Must Bolster Fight with China over Intellectual Property Rights," *The Hill*, March 10, 2017, <https://thehill.com/blogs/pundits-blog/economy-budget/323346-us-must-bolster-fight-with-china-over-intellectual-property>.

¹²⁵ Eftimiades, "The Impact of Chinese Espionage on the United States."

¹²⁶ "The People's Republic of China," *Office of the US Trade Representative*, accessed February 09, 2019, <https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china>

system and its effectiveness. Continuance of these issues has also led to negative impacts on U.S. industries, especially those using steel, high technology, and agriculture. China has expressed a desire to control entire supply chains within the global economy, which could lead to certain industries becoming controlled and manipulated largely by China; one of the prospective markets which has drawn Chinese interest is the cobalt industry, which now powers most modern electronics.¹²⁷ Again, this holds geopolitical implications as China could utilize this industry as economic leverage for future negotiations or to intentionally harm another country's economy.

Security and Military Implications: An Underlying Issue

What complicates this issue even more is the uncertainty of purpose surrounding all acts of espionage. Because of the wide applications of these advanced technologies, the lines have now become blurred between economic motivations versus military and security motivations. Some might wonder why it is not in our best interest to foster open collaboration and transparently share IP with China to better facilitate our economic relationship. In terms of U.S.-China relations, this would present a great opportunity for improvement, discussions, and collaboration. Nevertheless, the risk mainly lies in China's intended use of the IP, as much of it has military and security applications. As a result, the lack of trust that has persisted is greatly undermining any potential strong, stable relationship between China and the U.S. for the foreseeable future.

As our Task Force has discussed, the relevance of economic impacts and trade policy are ultimately of secondary importance, while China's pursuit for military strength and strategic global positioning present serious threats to the U.S. and the U.S.-led world order. Recently, Chinese hackers were able to infiltrate a Navy contractor database, securing highly sensitive data on submarine warfare.¹²⁸ This is an extremely concerning case in terms of national security and heavily adds to the growing distrust and uneasiness between the U.S. and China. The presence of these underlying issues have now created somewhat of a 'Cold War' situation in which both countries are primarily maneuvering behind the scenes and concealing their actual intentions and pursuits. Additionally, the Pentagon warned in 2017 that state-led Chinese investment in U.S. companies working on high technology operations such as VR, 3D printing, and autonomous vehicles have blurred the lines between consumer technologies and military technologies.¹²⁹ Serious military threats greatly exacerbate the uncertainty surrounding the intentions of the Chinese within the circumstances of many of these espionage cases. Not only do these

¹²⁷ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

¹²⁸ Ellen Nakashima, "China Hacked a Navy Contractor and Secured a Trove of Highly Sensitive Data on Submarine Warfare," *Washington Post*, June 8, 2018.

¹²⁹ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

developments possess risks to U.S. national security, they present even more threats to less developed and resourced Asian countries attempting to evade Chinese influence and control. Countries such as Singapore, Taiwan, Malaysia and Vietnam, all major allies, could be the first to see these impacts; as China's offensive military power continues to grow, it is able to extend its assertive foreign policy changing the balance of power in Asia.¹³⁰

What Steps Has the U.S. Taken?

As the threat of corporate espionage has increased, the United States government has taken further action to ameliorate these risks and discourage Chinese government involvement. Nevertheless, as China persists, it is evident that current policy measures and regulations remain insufficient and ineffective. In 2015, the Obama administration announced a "common understanding" with President Xi on curbing economic cyber espionage. This agreement threatened to impose U.S. sanctions on Chinese hackers who persist in committing cyber crimes, and implored punitive government action to be taken.

¹³¹ Although it has been noted that the quantity of attacks dropped since the agreement, government officials believe that China has still been violating the terms and have fallen short in enforcing restrictions on the accused parties.¹³² It is imperative that China become more responsible and accountable for such actions as the U.S. Justice Department is quite limited in its ability to take action against offenders abroad; the Justice Department may only prosecute offenders if they are American citizens or permanent residents- or if an act was committed in the U.S.¹³³ It is clear that the U.S. needs to seek different approaches to counteract this problem. They can continue to pressure Beijing to increase its monitoring and accountability measures, or they can make strides to grant more investigative and prosecuting power to the U.S. Justice Department in these cases; unsurprisingly, both solutions are difficult to achieve and would take time.

A crucial thing to note is how close the U.S. and China are nearing to an escalated trade war, with threats of major country-wide tariff increases. Given how China has made few adjustments in terms of espionage responsibility, it is becoming clear that these tariffs are not likely to have significant impacts on the issue of IP theft and hacking. Even with new guidelines and restrictions against hacking and IP theft, there remains no guarantee of an improvement in the current state of issues. The U.S. International Trade Commission Report also pointed out a potential flaw, citing how the slow pace of

¹³⁰ Eftimiades, "The Impact of Chinese Espionage on the United States."

¹³¹ Christopher Bing, "U.S. Accuses China of Violating Bilateral Anti-hacking Deal," *Reuters*, November 8, 2018.

¹³² Bing, "U.S. Accuses China of Violating Bilateral Anti-hacking Deal."

¹³³ Elias Groll, "Senate Bill Targets Chinese Economic Espionage," *Foreign Policy*, December 12, 2018, <https://foreignpolicy.com/2018/12/12/senate-bill-targets-chinese-economic-espionage/>.

legal action for IP infringement does not meet the needs of companies with rapid product life and profit cycles.¹³⁴ The high rates of innovation and adaptation within the cyber-landscape makes it difficult for these institutions to adequately respond and prevent attacks adequately. Consequently, legislative and congressional action only serves as part of the solution; a large part rests on innovations in cybersecurity measures and improved data security across vulnerable databases.

As discussed previously, foreign investment in the U.S. and other nations has become a new Chinese state-led industrial policy for IP theft. In terms of assessing these risks, there is the Committee on Foreign Investment in the US (CFIUS).¹³⁵ What is important to note is that the CFIUS was created in 1988 during trade conflicts with Japan and has been operational ever since. Considering that this agency has been active for over 30 years now and remains unable to adequately regulate Chinese foreign investment, it seems that the CFIUS is either underfunded or lacks sufficient legal power. Fortunately, Congress is now working on a bill to increase the purview of the CFIUS, which includes extending its oversight to U.S. investments in foreign countries.¹³⁶ This would mark a positive progression in preventing forced technology transfers and potentially lead to lessened economic reliance on China. There have been some additional signs of improvement and adaptations in policy from the U.S. government that show some signs of progress. Currently, congresswoman Kamala Harris is pushing a policy measure that would expand the jurisdiction of American prosecutors to bring economic charges against those who operate IP theft attempts outside national borders.¹³⁷ This presents a notable opportunity for improvement in terms of investigation and regaining capital lost by the victims of these espionage cases. Trump has also discussed the possibility of using executive powers to ban tech-related acquisitions by firms with at least 25% Chinese ownership and impose export controls on key technologies.¹³⁸ Although this proposal is increasingly protectionist, it seems that a shift in protectionism may be the only viable route for the U.S. to take at this point considering the economic and security implications that could continue to worsen. This section provides good points for assessment and improvement, but still leaves much left to be desired as acts of espionage and cyber theft show no signs of decreasing.

¹³⁴ Michelle Nash-Hoff, "What Could be Done about China's Theft of Intellectual Property?," *Industry Week*, February 09, 2016, <https://www.industryweek.com/what-could-be-done-about-chinas-theft-intellectual-property>.

¹³⁵ "The Committee on Foreign Investment in the US (CFIUS)," *U.S. Department of the Treasury*, January, 2019, <https://home.treasury.gov/policy-issues/the-committee-on-foreign-investment-in-the-united-states-cfius>.

¹³⁶ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

¹³⁷ Groll, "Senate Bill Targets Chinese Economic Espionage."

¹³⁸ McBride, "Is 'Made in China 2025' a Threat to Global Trade?"

Priorities for the U.S. and Actionable Policy Options

In order to better inform the rationale of the proposed policy options and recommendations that will be presented in the following section, it is useful to outline the key improvements the U.S. government should focus on, along with the priorities and values that the U.S. should not compromise. The U.S. should demand a measurable decrease in threats and attempts to steal IP and government information; ultimately, we realize that full stoppage is impossible. Subsequently, the U.S. should insist that the Chinese government take more responsibility and makes verifiable efforts in monitoring, deterring, and preventing acts of espionage against the United States. This must also include improvements in transparency and cooperative efforts from China's side during international espionage cases. When assessing these priorities and desired outcomes, it is key to remain aware of China's capabilities and our mutual investments. John Demers, former head of the Justice Department National Security Division, reiterates how the ultimate goal is not to fight with China, but to get Beijing to use legal methods to improve its economy.¹³⁹ Building off Demers' statement, none of the proposed policy recommendations should risk any major escalation of geopolitical tensions. In regards to the CFIUS department, we would like to see an improvement in their legal purview and capability for action. Ideally, the U.S. should also pursue the termination of joint venture requirements and forced technology transfers. Lastly, we should prioritize improvements in preventative measures for cybersecurity threats, both through antivirus software and increased awareness among U.S. citizens and internet users. This would likely be the most difficult outcome for the U.S. to achieve due to the difficulty of innovation and the inability to fully prevent all poor decisions made on the internet.

Building upon these priorities and desired outcomes for the United States, there are significant feasible options for the USTR to move forward positively and conservatively. First, we suggest that the USTR push for the permittance to deny the use of American banks to any foreign companies that have committed or benefitted from corporate espionage. Not only can this limit entrance of potentially threatening Chinese firms into the U.S. market, but it also may discourage future companies from committing acts of espionage and IP theft in the future. Additionally, we suggest enforcing stricter supply-chain accountability and regulations for U.S. companies investing in China. Michelle Nash-Hoff reiterates this more passionately, suggesting to companies that they should avoid going to China if possible, or if they do, they should never source all of the necessary product parts with one vendor.¹⁴⁰ This is an important point as it can reduce the risk of China tampering with and accessing the information possessed by U.S. firms. Additionally, if major U.S. companies began divesting, China would

¹³⁹ Rappoport, "Justice Department Charges Chinese Company with Espionage."

¹⁴⁰ Nash-Hoff, "What Could be Done about China's Theft of Intellectual Property?"

be forced to reevaluate their governance and responsibility in espionage cases. Nevertheless, reducing operations and investments in China may not be a desirable option for many U.S. companies, in the short run at least. We would also suggest enabling the WTO and concerned member countries to take punitive actions against China. In an interview with former WTO Chairman James Bacchus, he noted that the U.S. has had the opportunity to bring a case of intellectual property violations against China and has ultimately refrained from doing so.¹⁴¹ It is clear the U.S. has not had consistent faith in these international institutions, but viable actions within the WTO exist. Within the WTO there are systems such as the TRIPS Agreement which provides protection for trade secrets, and there are specific provisions prohibiting forced technology transfer.¹⁴² This would be a good platform for action, as the United States can enlist the help of key allies such as Europe, Japan, Korea, and others equally concerned about these issues. Additionally, China would be forced to adhere to any rulings or new regulations developed as they benefit significantly from WTO membership and would not want to jeopardize their status. Lastly, we highly recommend significant increases in funding and support for improved cyber-protection and conscious internet safety. This should require technology companies and private industries to collaborate with government agencies in developing artificial intelligence and advanced computing products that could help deter cyber threats. If properly funded and structured, this would help strengthen security measures and reduce points of vulnerability. In implementing these approaches, we hope that the U.S. government will be better prepared for espionage attempts, better equipped to act upon IP cases, and able to keep China accountable.

Policy Recommendations

- Encourage the USTR or Treasury Department to deny the use of U.S. banking system to any foreign companies that have committed or benefitted from the theft of American IP.
- Enforce stricter supply-chain accountability and regulations for U.S. firms looking to invest in or operate within China.
- Enable the WTO and equally concerned members to take punitive actions against China regarding IP laws.
- Increase funding and support for improved cyber-protection software, reinforcement of conscious internet safety practices, and improvements in the CFIUS department.

¹⁴¹ Waterman, Jeremie, “The WTO and the China Challenge”, *The Heritage Foundation*, November 30, 2018

¹⁴² Waterman, “The WTO and the China Challenge”

- If China does not meet these expectations and demands within an appropriate timeline, the U.S. must consider further punitive action such as: hacking back, blocking or limiting Chinese economic activity in U.S., imposing sectoral investment restraints, or even raising tariffs.

A NEW AGE OF TRADE: U.S. - JAPAN - SOUTH KOREA

Henry Mullin

What is the problem?

The Asia-Pacific region has long been of vital importance to the United States. Through economic, political, and military alliances with Japan and South Korea, the U.S. has been able to promote trade and assist in the overall security of an area with a long history of tension and protectionism. Since the end of the second World War, the United States and Japan have been productive trading partners and economic allies. Both nations are open to the other's international investment and remain reliant on the exports coming across the Pacific Ocean. While the overall significance of the trade relationship between the United States and Japan has diminished due to the rise of China, both countries still greatly benefit from the exchange that does take place. Recently, the United States made the decision to not join the Trans Pacific Partnership, raising more questions about what the trade relationship will look like between these two countries moving forward. A weak U.S.-Japan relationship would not only cause negative impacts on key industries such as automobiles and technology but would also destabilize trade with the entire Asia-Pacific community, putting a strain on other U.S. trade partnerships. Moving forward, it is imperative that the two global powers create a formal trade agreement in order to continue economic prosperity and counter the global threat posed by the rise of China.

In addition to the importance of Japan in advancing trade and security in the Asia Pacific, South Korea remains a close economic and military partner of the United States. In 2012, the U.S. and South Korea entered into a Free Trade Agreement, eliminating tariffs, promoting economic growth, and reinforcing a partnership between the two nations.¹⁴³ The ability of the two governments to create this economic alliance is a demonstration not only of the United States' growing interest in protecting and increasing trade with our Asia-Pacific allies, but also an indication of the potential for further formal agreements in the region. As the U.S. continues its trade war with China, the other economic relationships in Asia are being tested. China continues to grow and threatens to become relatively economically self-sufficient by 2025, while increasing its military power and influence. Since 2008, China, South Korea, and Japan have been in talks about establishing a trilateral trade agreement but have been unable to reach a consensus as the Chinese remain reluctant to compromise on key industries and tariff

¹⁴³ "Summary of the U.S.-Korea FTA," Summary of the U.S.-Australia Free Trade Agreement, *Office of the United States Trade Representative*, accessed February 05, 2019, <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2009/april/summary-us-korea-fta>.

issues. The willingness of Japan and Korea to foster interdependent economic relations has continued to grow over the past decade, with levels of both trade and investment increasing between the two countries.¹⁴⁴ Their cooperation is crucial to the stability and economic production in the Asia-Pacific. Additionally, as both are close economic allies of the United States, the possibility of a multilateral agreement would mean expanded trade across the Pacific as well as a formidable alliance combating the rise of China. If the current global order is to be protected and the United States hopes to remain in a powerful position on the international economic stage, it is essential that all three industrialized powers – the United States, Japan, and South Korea, enter into a trade agreement. This deal must promote trade amongst them, advance their economic goals, and limit the extent to which China can dominate both the economic market and the geographic region.

The United States' Interests

The end of World War II brought about the global, economic, and political hegemony of the United States. The establishment of the Bretton Woods system, including the implementation of the General Agreement on Tariffs and Trade (GATT), the International Monetary Fund (IMF) and the World Bank, ushered in a new era of U.S.-led free trade. Today, the position of the United States as the global leader and promoter of free trade is being tested by the rise of nationalism in Asia, the rise of China, and the desire by the U.S. to protect and promote its own industries. As a result, U.S.-led free trade remains more important than ever. As discussed in previous chapters, the rise of China and the threat posed by the *Made in China 2025* plan looms over the United States and our trading partnerships with economic allies; Japan and South Korea. In 2017, the Center for Strategic and International Studies (CSIS) reported that the consumer market, high quality goods, and access to capital creates a vital trade and investment partnership between the U.S. and Asia, specifically Japan and South Korea. This illustrates the importance of the United States and its role in the Asia Pacific, both in terms of military and political stability, as well as economic prosperity. Beyond economics, the United States has upheld the security order in the Asia-Pacific and been a “lynchpin of regional peace and stability.”¹⁴⁵

As described above, the current world order relies on the leadership of the United States in the Asia-Pacific. Both sides reap major economic and international security benefits from the partnerships

¹⁴⁴Kim Gyu-Pan, “Korea’s Economic Relations with Japan,” Korea Economic Institute of America, 2016, http://www.keia.org/sites/default/files/publications/koreaseconomy_ch4_koreas_economic_relations_with_japan.pdf

¹⁴⁵ “U.S. Economic Strategy in the Asia Pacific: Update and Recommendations,” Center for Strategic & International Studies, last modified October 2017, https://csis-prod.s3.amazonaws.com/s3fs-public/publication/171010_Goodman_USEconomicStrategyAsiaPacificUpdate_Web.pdf?sSZOM_hesksuvl1hBrWIRqsQaP4VkmB

that exist, but these relationships continue to be tested in an era of rising nationalism in the United States and across the Pacific Ocean. If the United States remains focused on being a global leader and preserving its position at the head of the world order, it is necessary to establish more formalized and cooperative agreements with Japan and Korea. If we do not, the U.S. will watch from the sidelines as agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the Association of Southeast Asian Nations (ASEAN) create powerful relationships within Asia that shape the next global order.¹⁴⁶ These agreements, specifically the RCEP, would bring together many of the Southeast Asian nations, including China, Japan and South Korea. The RCEP would create a free-trade area between its member states, which would include 3.6 billion people and produce \$25 trillion in GDP, greater than that of the United States.¹⁴⁷ The RCEP proposal came after the United States and the Trump administration's decision to not join the TPP. While this agreement is still under intense negotiations, it demonstrates Asia's (and specifically China's) ability to challenge the role of the United States as the hegemonic power. Furthermore, Japan's desire for formalized trade agreements is increasingly amplified with the EU – Japan Economic Partnership agreement. Not only will this agreement eliminate trade barriers on the almost \$200 billion in goods and services traded between these two powers; it will also establish the rejection of protectionism from two of the world's largest economies.¹⁴⁸

In addition to these partnerships threatening the United States as a global leader and the dominant international force, they also threaten U.S. industries and domestic job creation. Workers are currently suffering in the United States as a result of the trade war with China. The Trump administration remains adamant about the tariffs being implemented on imported goods from China, but ultimately the tariffs are paid for by U.S. consumers.¹⁴⁹ Furthermore, the reciprocal tariffs China has placed on U.S. goods have hurt farmers and other producers in the United States. With more and more workers relying on short-term subsidies and support from the U.S. government,¹⁵⁰ it is clear that a new solution must be found to end the trade war with China and put Americans back to work. In order to revitalize the American economy and promote these domestic producers, the role of the tariff must be seriously reduced. While the trade war with China is likely to continue for some time, it is important to

¹⁴⁶ "U.S. Economic Strategy in the Asia Pacific," Center for Strategic & International Studies.

¹⁴⁷ Peter Petri and Michael Plummer, "The Case for RCEP as Asia's next Trade Agreement," *Brookings*, November 05, 2018, <https://www.brookings.edu/order-from-chaos/2018/11/06/the-case-for-rcep-as-asias-next-trade-agreement/>.

¹⁴⁸ "The Economic Impact of the EU – Japan Economic Partnership Agreement (EPA)," an analysis prepared by the European Commission's Directorate-General for Trade, European Commission, last modified June 2018.

¹⁴⁹ Michael Collins, "American Farmers, Businesses Launch Campaign to Show How Tariffs Harm the Heartland," *USA Today*, Accessed February 22, 2019.

¹⁵⁰ Monica Davey and Patricia Cohen, "Trade War Prospect Shakes Part of Trump Base: Midwest Farmers," *The New York Times*, March 10, 2018, <https://www.nytimes.com/2018/03/10/business/economy/tariffs-farmers.html>.

not continue to have conflict with Japan and South Korea, key allies of the United States. The region is essential for U.S. trade and investment and, as reported by the CSIS, the economic size of the Asia-Pacific has more than tripled since the end of the Cold War, and trade between these nations and the United States has grown more than 200%. This increased trade has led to job growth across the U.S., and as the Asia Pacific continues to develop, creates the opportunity for further American job growth.¹⁵¹

Between Japan and South Korea, two of the United States' top trading partners in the region, U.S. exports in 2017 totaled over \$100 billion, the majority of which was made up by computers, transportation equipment, chemicals, and agricultural goods.¹⁵² With so much economic opportunity comes increased domestic competition, specifically from Japan's auto and semiconductor industry. In South Korea, however, the current free trade agreement promotes the opening up of the Korean market to an increasing number of U.S. autos.¹⁵³ Additionally, the farming industry in the United States relies on the Japanese market as the 4th largest importer of agricultural goods, with the value totaling \$12 billion in U.S. exports in 2017.¹⁵⁴ As the Trump administration remains locked in a trade war with China, the tariffs being placed on American goods by China are falling primarily on agricultural products. In order to support farmers and promote positive relations between the U.S. and Japan, cooperation between the two nations must accelerate and remain steadfast.

Finally, the United States military has maintained a presence in Japan and South Korea, ensuring peace and security in the region since the end of World War II in 1945 and the Korean War in 1953. There are currently around 50,000 U.S. military members stationed in Japan, and 28,000 serving in South Korea, both more than any other country in the world.¹⁵⁵ Following WWII, Japan was not allowed to form their own military, relying on the presence and commitment of U.S. troops to protect the island nation. Japan does currently employ a Self Defense Force, tasked with domestically protecting the nation, but only has limited authority to participate in foreign military action. As China's power grows and threatens Japan, the role of the United States will be more necessary than ever to preserve peace in the region and the integration of the Japanese and U.S. militaries is likely to accelerate. Indeed, the U.S. wants Japan to become a more active military power in the Pacific because the U.S. realizes it can no

¹⁵¹ "U.S. Economic Strategy in the Asia Pacific," Center for Strategic & International Studies.

¹⁵² "National Trade Data," Trade Stats Express, accessed February 05, 2019, <http://tse.export.gov/tse/ChartDisplay.aspx>.

¹⁵³ "U.S. - Korea Free Trade Agreement," Summary of the U.S.-Australia Free Trade Agreement, *Office of the United States Trade Representative*, accessed February 05, 2019, <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta>.

¹⁵⁴ "Japan," Summary of the U.S.-Australia Free Trade Agreement, *Office of the United States Trade Representative*.

¹⁵⁵ Hannah Beech, "What to Know About the U.S. Military Presence in Japan," *Time*, June 08, 2016, <http://time.com/4360940/us-military-navy-japan-okinawa-alcohol-bases/>.

longer afford to do all that is needed to cope with the rise of China. In South Korea, both militaries carry out joint operations and exercises. This has been an issue as tensions between North Korea and South Korea are easing, while the United States remains locked in the pursuit of denuclearization.¹⁵⁶ The role of the U.S. military in the Asia-Pacific continues to be a contentious issue, but a necessary practice to preserve peace and stability in the region. Most Asia-Pacific countries, other than China, want the U.S. military to be active in the Pacific because they believe its presence is an important stabilizing factor, especially now that China is becoming more assertive militarily.

After analyzing the United States' position in the global economy, and recognizing the value of trade, commerce, and security in the Asia-Pacific, it is clear that significant action must be taken to ensure positive relations are maintained with Japan and South Korea. Due to the threat of Chinese advancement and their ambition to unify the nations of East and Southeast Asia, a formal trade agreement between the United States, Japan, and South Korea, would not only promote U.S. industry, trade, and military interests, but also benefit the economic and geopolitical interests of Japan and South Korea.

Japanese Background and Economic Interests

During the post-war period, Japan experienced an unprecedented rise into a fully developed economy and a global power. Due in part to both aid and assistance from the United States and the actions of their own government and businesses, Japan was able to grow to the point of being the world's second largest economy. This was accomplished through the government's industrial policy, specifically focusing on the production of raw materials and textiles.¹⁵⁷ Japan's growth and emergence onto the global stage increased throughout the Cold War period, but in the 1990's, the economic bubble they had created burst, and growth began to stagnate. The economy became defined by low growth, deflation, unemployment, and a debilitating amount of debt.¹⁵⁸ Today, Japan's economy continues to be the third largest in the world, but still struggles with the issues of an aging population and a rise in nationalistic policies implemented under Prime Minister Abe. If it hopes to become more prosperous, Japan will need to combat not only its domestic issues, but also ensure positive international relations.

¹⁵⁶ Tom Vanden Brook, "Pentagon Bases about 28,000 U.S. Troops in South Korea," *USA Today*. June 05, 2018, <https://www.usatoday.com/story/news/politics/2018/06/05/u-s-bases-28-000-troops-south-korea-summit-june-12/671126002/>.

¹⁵⁷ David Henderson, "Japan and the Myth of MITI," *The Concise Encyclopedia of Economics* (Library of Economics and Liberty), accessed March 4, 2019, <http://www.econlib.org/library/Enc1/JapanandtheMythofMITI.html>.

¹⁵⁸ "Japan's New Economic Challenge," Council on Foreign Relations, accessed February 05, 2019, <https://www.cfr.org/expert-brief/japans-new-economic-challenge>.

In 2013, Prime Minister Shinzo Abe implemented what is widely referred to as ‘Abenomics’: a set of policies and economic practices designed to boost domestic demand and GDP through structural reform, fiscal expansion, and monetary easing.¹⁵⁹ Overall, the growth rate of the Japanese GDP has dropped from 4.4% growth in 2012 to 1.7% 2017.¹⁶⁰ To try and reverse this trend, the Japanese government implemented a \$210 billion stimulus package centered around the construction of bridges, tunnels, and roads during Abe’s first year in office. The spending of the Abe administration is designed with the goal of economic growth in industries such as energy and automobiles in order to revitalize the Japanese economy. In his plan regarding trade, Abe’s monetary policy dramatically weakened the yen as soon as he took office, helping Japanese exports, and making it cheaper to invest in Japan. The United States is a key importer of Japanese products, so it is important for Japan to limit any U.S. tariffs in order to keep U.S. demand and Japanese production high. This was the goal of the TPP, which was heavily pushed by both President Obama and Prime Minister Abe, who even contradicted the top Japanese agricultural collective, believing the benefits of trade and investment liberalization would outweigh the potential increase in imports harming Japanese agriculture firms. Abe’s aim was to limit China’s economic abilities while maintaining what he has called the “cornerstone of Japanese foreign policy” in the relationship Japan has with the United States.¹⁶¹

Many of Prime Minister Abe’s policies have been focused around promoting Japanese industry and exports, while trying to limit the fiscal budget and maintain high levels of investment. Japan would benefit from a trade agreement that ensures fair levels of trade and investment between them and the United States, ensuring that there is no form of currency manipulation. This partnership will also aid both countries’ goal of containing China. Recently, the United States has re-engaged in talks with Japan, working towards building a mutually beneficial trade agreement. Both nations agree that the rise of China threatens economic prosperity and geopolitical security in the region and want to come to an agreement that limits China’s ability to do so. The agreement is also supposed to set high trade, intellectual property protection, and investment standards, promoting both U.S. and Japanese industries and creating jobs in both countries.¹⁶² The cooperation of the U.S. and Japan is necessary and mutually beneficial.

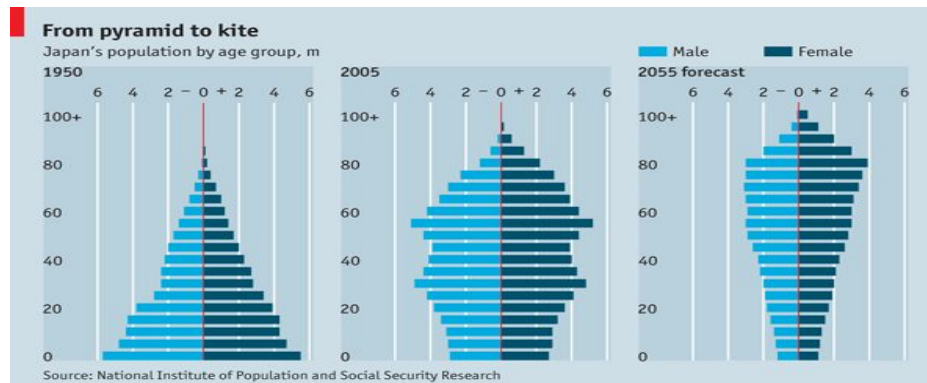
¹⁵⁹ "Abenomics and the Japanese Economy," Council on Foreign Relations, Accessed February 05, 2019, <https://www.cfr.org/backgrounder/abenomics-and-japanese-economy>.

¹⁶⁰ "GDP (Current US\$)," World Bank, accessed March 04, 2019, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>.

¹⁶¹ "Abenomics and the Japanese Economy," Council on Foreign Relations.

¹⁶² "Joint Statement of the United States and Japan," The White House, accessed February 05, 2019, <https://www.whitehouse.gov/briefings-statements/joint-statement-united-states-japan/>.

While Japan has developed into a leading global economy, an aging population threatens to reduce economic output and limit future growth. By the year 2055, four out of ten Japanese will be over 65 and the size of the workforce is projected to be smaller than it was in 1950.¹⁶³ Lower fertility rates and increasing life expectancy levels have led Japan to have a higher old-age dependency ratio than any other developed country, with one elderly person predicted to be the financial responsibility of two working age people by 2025.¹⁶⁴ This shift is illustrated in the graph below and demonstrates the shrinking of the Japanese workforce and consequently, Japan's ability to produce.



Source: *The Economist*. "The Old and the Older."

For an economically powerful nation such as Japan, the aging population indicates serious concerns about the ability to continue producing at their previous levels. Employment will be down - not due to a shortage of jobs, but a shortage of workers able to fill the positions companies need to stay competitive. Industries will struggle to compete against the growing economies in Vietnam and Indonesia, unless they find innovative ways to maintain high levels of economic output. At the end of World War II, Japan faced a similar economic issue, with industries struggling to compete and produce due to the destruction caused during the conflict. The strategy to bring Japan out of economic decline was state-led investment in certain industries they felt would help bring Japan out of economic stagnation and into a stable economic situation. Currently, however, the use of state-led investment and the implementation of fiscal policy to aid productivity will be limited due to the need to fund the pensions of the country's aging workforce.¹⁶⁵ The Japanese government has invested heavily over the past decade trying to bring the country out of the recession, leaving very little room to spend on increasing social security. As a

¹⁶³ "The Old and the Older," *The Economist*. November 19, 2010, accessed February 05, 2019, <https://www.economist.com/graphic-detail/2010/11/19/the-old-and-the-older>.

¹⁶⁴ Hamid Faruqee and Martin Mühleisen, "Population Aging in Japan: Demographic Shock and Fiscal Sustainability," *NeuroImage*, September 11, 2002, accessed February 05, 2019, <https://www.sciencedirect.com/science/article/pii/S0922142502000178>.

¹⁶⁵ Faruqee et al. "Population Aging in Japan: Demographic Shock and Fiscal Sustainability."

result, Japan's government debt as a percentage of GDP is about 250%, higher than any other industrialized country.

The aging population affects not only the Japanese economy, but that of other Asian nations and the United States as well. As more Japanese firms face the reality of shrinking markets at home, they are increasingly setting up more factories abroad, including China, Vietnam, Malaysia, and India, bringing economic prosperity and job creation to these countries. However, the United States is a primary market for Japanese goods, buying \$169.5 billion worth of goods in 2017, or about 24% of Japan's total exports.¹⁶⁶ New countries receiving investment and increased production from Japanese industries may not have as equal or stable trade relationships with the United States, leaving the potential for a decline in trade between the U.S. and Asia. For the United States, many of Japan's largest automotive companies, including Honda, Toyota, and Nissan, already produce massive amounts of their vehicles in the United States. In 2015, these three manufacturers annually produced 3.85 million units collectively in the U.S.¹⁶⁷ With \$45.4 billion invested in the United States economy by these producers, the shift in Japan's manufacturing locations could lead to further investment from other countries into the United States.¹⁶⁸ The ability for Japan to maintain a key market in the U.S. is necessary for their own economic stability. This can only happen with the establishment of more direct and reciprocal ties between the two nations and their continued cooperation as allies and trading partners. If not, not only will Japan struggle in deciding where to locate production, but the U.S. could potentially lose the investment Japan has already made if their economy stagnates and begins to crumble.

As Japan continues to struggle with an aging population and a shrinking workforce, positive and productive economic relations with the United States are more important than ever. A partnership with specific standards for investment, the reduction of tariffs on key goods, and the opportunity to expand production would lead to increased economic prosperity for both countries. Additionally, the alliance of two of the world's largest economies and global powers would limit the extent to which China could take control of the Asia-Pacific region and the international economy. The United States currently occupies the position of China's top trading partner, with Japan and South Korea taking the third and fourth spots respectively (Hong Kong is number two). Together, these three allies receive almost 30% of all Chinese exports.¹⁶⁹ Aside from being trading partners, all three nations are wary of China's growing

¹⁶⁶ "Japan," *United States Trade Representative*.

¹⁶⁷ Dan Eaton, "Japan's Big 3 Automakers Built More Cars in U.S. than Detroit 3 Last Year," *Columbus Business First*, accessed March 4, 2019, <https://www.bizjournals.com/columbus/news/2016/06/01/japans-big-3-automakers-built-more-cars-in-u-s.html>.

¹⁶⁸ Eaton, "Japan's Big 3 Automakers."

¹⁶⁹ "China's Top Trading Partners," *World's Top Exports*, January 25, 2019, accessed February 05, 2019, <http://www.worldstopexports.com/chinas-top-import-partners/>.

power and push for control in the Asia Pacific domain. A formal trade agreement giving preferential status to goods going between the United States, Japan, and South Korea would limit China's ability to dominate trade in the region and be a positive economic result for the three countries. While all three nations rely on certain manufactured goods from China, limiting or eliminating the import that can be provided by the other members of this agreement would lead to increased security and economic prosperity. The goal of limiting China's influence can happen through a formal trade agreement and a commitment to aid and help grow the Japanese economy. Both the United States and Japan are primed to play key roles in how the Asia-Pacific situation plays out in the coming years, but it is important to recognize that the economic strength of South Korea is also key to a stable Asia-Pacific region.

South Korean Background and Economic Interests

In what is widely considered to be an economic miracle, South Korea has grown into one of the world's most productive economies. Up until the mid- 1980's, South Korea used a variety of direct government investment through industrial policies and protectionist measures to help promote infant industries such as steel, shipbuilding, autos and semiconductors. This allowed them to develop efficient manufacturing industries and become a major trading partner of the United States. Currently, as the United States' seventh largest trading partner, South Korea is an essential ally. The United States and South Korea have a current free trade agreement in place (KORUS), although tensions remain high as the Trump administration has made significant changes to the agreement in the hope of supporting more American jobs and decreasing the trade deficit.¹⁷⁰ Tensions are also high because the U.S. and South Korea have different approaches to how best resolve the North Korea nuclear weapons problem.

Being trading partners with both China and the United States, South Korea is caught in the crossfire of the trade war, with about 25% of their exports destined for China.¹⁷¹ The trade relationship between the United States and South Korea is positive but can still be improved upon to maximize economic activity and trade between the two nations. It is essential for the United States to maintain their FTA status in order to demonstrate to the international community, specifically Japan and China, that we are willing and able to take part in bilateral agreements for the betterment of all countries involved.

The United States and the Republic of Korea signed their first bilateral free trade agreement on June 30, 2007. This comprehensive trade agreement was designed to eliminate tariffs and other barriers

¹⁷⁰ "President Donald J. Trump Is Fulfilling His Promise on the United States–Korea Free Trade Agreement and on National Security," The White House, <https://www.whitehouse.gov/briefings-statements/>

¹⁷¹ "South Korea: Economy Showing Signs of Resilience," Deloitte United States, Accessed February 05, 2019, <https://www2.deloitte.com/insights/us/en/economy/asia-pacific/south-korea-economic-outlook.html>.

to trade in goods and services, promote economic growth, and strengthen economic ties between the United States and Korea.¹⁷² With the agreement, nearly 95% of U.S. exports in industrial and consumer electronic machinery and parts, auto parts, power generation equipment, and other key exports had the tariffs removed. The signing of KORUS signified the commitment of the two countries to foster a positive economic and political relationship. South Korea became further entrenched as a major market for U.S. autos through the elimination of most tariffs. The tariffs on farming and agricultural products were also eliminated, establishing South Korea as the fifth largest market for U.S. goods in 2017, a very important partner as tariffs continue to hurt U.S. agricultural exports to China.¹⁷³ This deal, however, was reconstructed as one of President Trump's initial actions once taking office. The new amendments, including the doubling of American automobiles from 250,000 to 500,000 that can enter the South Korean market tariff free, are designed to protect auto industry jobs in the United States and increase American exports.¹⁷⁴ Other amendments include fair treatment of U.S. pharmaceutical exports, as well as tariffs on the annual import volume of South Korean steel.¹⁷⁵ While these policies are designed to benefit U.S. manufacturing and jobs growth, they threaten certain South Korean industries and have created tension between the two countries. As pressure mounts between the United States and China, the continuation of and commitment to KORUS is imperative for U.S. trade in the Asia-Pacific. As a key market for U.S. goods and services, South Korea continues to be a necessary ally. Furthermore, the complex relations between South Korea, China, and Japan, put a strain on U.S. leadership in the region.

The issues with KORUS are rooted in President Trump's desire for South Korea to purchase more goods, as the U.S. had a trade deficit with South Korea of \$23.1 billion in 2017.¹⁷⁶ This issue, however, is not as pressing as the need for the U.S. to understand the complicated relationship between South Korea and China. If the United States fails to come to agreement with both China and South Korea, these two powerful nations will only become more interdependent, isolating the U.S. from two key Asian markets. The goal must be to ensure that the economic and diplomatic relationship between South Korea and China does not undermine U.S. economic opportunities in the region. In order to do this, the United States needs to recognize that South Korea has reached the economic development point of no longer being a junior partner in the trade partnership and understand that they are looking for a trade agreement that reflects a greater level of equality. South Korea has been the leading nation in wanting to establish more Asian interdependence and integration. Discussion between the three Asian powers

¹⁷² "Summary of the U.S.-Korea FTA" *United States Trade Representative*.

¹⁷³ "U.S. - Korea Free Trade Agreement," *United States Trade Representative*.

¹⁷⁴ "United States – Korea Free Trade Agreement," The White House.

¹⁷⁵ "United States – Korea Free Trade Agreement," The White House.

¹⁷⁶ "U.S. - Korea Free Trade Agreement," *United States Trade Representative*.

over a trade agreement has been tumultuous since formal meetings began in 2012, but the United States should still be concerned about the possibility of the formation of a powerful Asian trading block, most likely led by China. Whether this is the RCEP, or a trilateral agreement between China, Japan and South Korea,¹⁷⁷ the United States needs to leverage its relationship with South Korea and Japan and create a formal, trilateral agreement in order to better serve the economic interests of all three nations, as well as limit China's ability to continue its geopolitical growth. This idea will be further expanded upon in the following chapters on Japan and South Korea, respectively.

The relationship between the U.S. and South Korea is further complicated by the role of North Korea and how each country has gone about creating diplomatic ties with its dictator, Kim Jong Un. Through joint economic and political ventures, South Korea has taken a more productive approach towards their relationship with North Korea. Through a joint railroad project, sporting exchanges, and direct economic investment, South Korea and President Moon Jae-In are spending hundreds of millions of dollars to promote integration and unification. The relationship between the two has also led to an agreement on the reinstatement of a joint military commission, allowing family reunifications, and a bid to jointly host the 2032 Olympics.¹⁷⁸ South Korea views the conflict with North Korea much differently than the U.S. does, creating tension as the United States remains determined to complete the process of denuclearization. South Korea is more focused on preventing even a small military skirmish, given that Seoul is only a few dozen miles from the border with North Korea. Furthermore, the South Korean government is committed to creating a positive economic and political partnership to help North Korea economically, which is their most current pressing issue.

The development of the relationship between North Korea and South Korea complicates the United States' desire to ensure the quick denuclearization of North Korea in order to ensure military stability in the region. Ties between the U.S. and South Korea are strained, as the United States feels denuclearization is being slowed down as North Korea – South Korea diplomacy and partnerships increase.

¹⁷⁷“Trilateral Trade Talks Resume Between China, Japan, and South Korea,” International Centre for Trade and Sustainable Development, March 29, 2018, <https://www.ictsd.org/bridges-news/bridges/news/trilateral-trade-talks-resume-between-china-japan-and-south-korea>.

¹⁷⁸ Nyshka Chandran, "South Korean Peace Efforts Look 'out of Sync' with Elimination of North Korean Nukes," *CNBC*, December 05, 2018, <https://www.cnbc.com/2018/12/05/south-korea-north-korea-ties-improve-as-denuclearization-lags.html>.

Conclusion

The relationship between the United States and our allies in Japan and South Korea is now more important than ever. Due to the increased instability in the region as a result of the U.S.-China trade war and the overall rise in China's economic, political, and military might, it is imperative to maintain high levels of cooperation and establish a more formal trade agreement. While the current administration is focused on the issue of balancing the United States' trade deficit, it is far more important to create positive partnerships and agreements for the long-term economic prosperity and geopolitical security of the United States, Japan, and South Korea. It is also important to recognize that the current relationship between South Korea, China, and North Korea may complicate the negotiation process. It is unrealistic and unwise to entirely isolate China from trade amongst the United States and Asia, but a trilateral agreement will limit the extent to which China is able to dictate this trade. This idea will be further expanded upon in the following chapters on Japan and South Korea, respectively.

Through reciprocity and the maximization of our common interests, a trilateral agreement between the U.S., Japan, and South Korea will pave the way for increased economic success and stability throughout the region. Therefore, we recommend the following policies:

Policy Recommendations

- Encourage the executive branch and particularly the President to use constructive and cooperative language in all negotiations with Japan and South Korea, avoiding isolation and leading towards joint partnerships. This communication should for the most part be private between experts, not conducted publicly through tweets and social media. Conducting talks respectively and professionally is important to all of these East Asian nations, making the public outbursts and disrespectful rhetoric unacceptable.
- Promote Japanese and South Korean investment in the United States in industries such as tech and autos in order to foster strong economic relations and create more U.S. jobs.
- Establish a trilateral trade agreement between Japan, South Korea, and the United States, focused on increasing trade, eliminating trade barriers, growing industries in all member states, and limiting the extent of China's growth and economic influence.

U.S. - JAPAN TRADE RELATIONS

Koki Sato

Japan has been a key ally to the United States in East Asia with strong economic and military relations since 1945. However, with the inauguration of President Trump, the relationship between the U.S. and Japan has been altered. On March 1, 2018, President Trump announced his decision to impose 25% tariffs on steel and 10% tariffs on aluminum.¹⁷⁹ Many U.S. allies became subject to the tariffs, including Japan. Since then, while some nations such as South Korea, Japan's next-door neighbor, were granted exemptions, Japan is still affected by the tariffs. President Trump, who finds the trade deficit between the U.S. and Japan unfavorable, \$55.5 billion¹⁸⁰ in 2018, has taken a very stern stance on Japan. In addition to the steel and aluminum tariffs, President Trump has threatened Japan with potential tariffs on automobiles.

Though the idea of tariffs may seem intriguing, offering protection to certain industries and increasing government revenue, in the long run tariffs will reduce the overall level of employment.¹⁸¹ The U.S. implementation of these tariffs not only negatively affects Japanese industries but negatively affects U.S. industries, consumers, and workers as well. Removing the steel and aluminum tariffs in place and dismissing the idea of placing tariffs on Japanese automobiles will be beneficial for both nations. This would allow the U.S. to continue to maintain strong economic and diplomatic relations with Japan. In a global landscape where China's influence is growing, Japan is a key ally in East Asia for the containment of China and sustained U.S. presence in East Asia. The U.S. must continue to strengthen its relationship with Japan in order to continue to be a strong political actor in Asia.

The U.S. and Japan have recently started dialogue for a bilateral trade agreement. While the economic benefits will be advantageous for both nations, the U.S. should see this as an opportunity to strengthen its presence in East Asia. The U.S. already has a bilateral trade agreement in place with South Korea, and with the U.S. entering into discussions with Japan, there is a possibility of two bilateral trade agreements in place between the U.S. and two key nations in East Asia separately. Two distinct bilateral trade agreements would be beneficial in terms of the economy, but a trilateral trade agreement will be in the United States' best interest economically and geopolitically. A trilateral trade agreement is preferable because it will give the U.S. a chance to strengthen their diplomatic relationship with the two

¹⁷⁹ David Lynch et al., "Trump Imposes Steel and Aluminum Tariffs on the E.U., Canada and Mexico," *The Washington Post*, May 31, 2018, accessed January 26, 2019.

¹⁸⁰ "Japan," Office of the United States Trade Representative.

¹⁸¹ Sawyer, *U.S. International Trade Policy: An Introduction*.

nations through a strong formal agreement. In 2018, in response to U.S. tariffs, Japan, South Korea, and China have resumed discussion for a free trade agreement.¹⁸² Even though Japan and South Korea have very different policies compared to China, which has led to little progress in these FTA discussions, the U.S. must take this as a wakeup call. The strengthening of economic relations through a trilateral agreement between the U.S., Japan, and South Korea could be the cornerstone in containing China and isolating them within the region. Before examining the benefits of a trilateral trade agreement, the current economic relationship between Japan and the U.S. will be discussed.

Trade Deficit

Recently, the United States' widening trade deficit has been labeled as the cause of economic ailments such as unemployment and weak economic growth.¹⁸³ President Trump through his time in office has shown his determination to eliminate trade deficits with U.S. trading partners. Japan has the third largest trade deficit with the U.S. at \$55.5 billion, behind China and Mexico.¹⁸⁴ President Trump placed tariffs on Japan to minimize the large trade deficit between the U.S. and Japan. However, the U.S. runs a trade deficit with numerous nations and contrary to President Trump's beliefs, trade deficits with Japan are not a huge problem. Some of the net extra dollars earned through trade with the U.S. are used to buy American goods,¹⁸⁵ but most of the excess dollars are reinvested into U.S. assets such as U.S. Treasury securities.¹⁸⁶ Though there is a trade deficit, this re-investment allows Japan to be one of the biggest purchasers of U.S. Treasury securities at \$1.02 trillion, only second to China.¹⁸⁷ The money used to pay for imports flows back into the U.S. as new capital that funds U.S. government debt.¹⁸⁸ In 2017, the U.S. ran a total trade deficit of about \$552 billion, but foreign countries sent about the same amount back as investment in U.S. Treasury bills and foreign direct investment (FDI). This allowed for the

¹⁸² Laura Zhou, "China, Japan, South Korea Aim to Speed up Free-trade Agreement Talk," *South China Morning Post*, September 21, 2018, Accessed January 28, 2019, <https://www.scmp.com/news/china/diplomacy/article/2165260/china-japan-and-south-korea-aim-speed-talks-free-trade>.

¹⁸³ Amanda Augustine, et al., "U.S. - The Trade Deficit: Don't Fear the Beast," BBVA Research RSS, March 08, 2017, accessed January 27, 2019, <https://www.bbva.com/en/publicaciones/u-s-the-trade-deficit-dont-fear-the-beast/>.

¹⁸⁴ "Japan," Office of the United States Trade Representative.

¹⁸⁵ "Japan," Office of the United States Trade Representative.

¹⁸⁶ Contractor, "Ten Quick Facts about US Trade: Deficits and Discords."

¹⁸⁷ Treasury International Capital (TIC), accessed January 27, 2019, <http://ticdata.treasury.gov/Publish/mfh.txt>.

¹⁸⁸ William D Lastrapes, "An Economist Explains Why Trade Deficits Aren't a Bad Thing," World Economic Forum, October 16, 2018, <https://www.weforum.org/agenda/2018/10/why-trade-deficits-aren-t-so-bad/>.

creation of jobs and an increase in U.S. economic growth.¹⁸⁹ Therefore, the steel and aluminum tariffs implemented to address the deficit are unnecessary and have strained U.S.-Japan relations.

Steel and Aluminum

Background

As previously mentioned, President Trump is determined to reduce the current trade deficit between the U.S. and Japan. The steel and aluminum tariffs imposed on Japan can be considered as a policy to pressure Japan into purchasing more U.S. products in order to decrease the trade deficit.¹⁹⁰ But as discussed previously, the bilateral trade deficit is not necessarily a complete negative for the U.S. economy and the steel and aluminum tariffs imposed on Japan have negatively affected U.S. relations with Japan. Japan has also announced it is considering plans to hit U.S. imports worth up to \$400 million with tariffs in retaliation against President Trump's steel and aluminum tariff.¹⁹¹ In addition to deteriorating diplomatic relations, the steel and aluminum tariffs have had negative effects on the U.S. economy as well.

It is important to understand the significance of both industries in each nation. The steel industry is a very important sector for Japan as steel is the fourth most exported good from Japan. Japan exports about \$30 billion worth of steel, around 4.2% of the total export economy.¹⁹² The steel industry accounts for around 7.2% of Japan's manufacturing industry which produces around \$58 billion in value.¹⁹³ Japan is the world's second biggest producer of steel, producing a total of 105.15 million metric tons of steel, second to China which produces an astronomical 803.83 million metric tons of steel.¹⁹⁴ Japan exports about 20% of their steel. Their top three markets in 2018 were Thailand, South Korea, and China. The U.S. was eighth on the list, accounting for 4% of Japanese steel exports.¹⁹⁵ Overall, the steel

¹⁸⁹ Lastrapes, "An Economist Explains Why Trade Deficits Aren't a Bad Thing."

¹⁹⁰ Masaya Kato, and Yuta Koga, "Trump Presses Abe to Buy More US Military Gear," *Nikkei Asian Review*, September 29, 2018,

<https://asia.nikkei.com/Economy/Trade-War/Trump-presses-Abe-to-buy-more-US-military-gear>.

¹⁹¹ "Japan Plans \$400m Hit on US Goods in Response to Trump Tariffs," *The Guardian*, May 17, 2018, <https://www.theguardian.com/2018/may/17/japan-plans-400m-hit-on-us-goods-in-response-to-trump-tariffs>.

¹⁹² "Nihon no omona yushutsunyuuhin JFTC kids site JFTC ipan shadan houjinn nihon bouekikai," 日本の主な輸出入品 | JFTC キッズサイト | JFTC - 一般社団法人日本貿易会," [Japan's main exports] Accessed February 12, 2019. http://www.jftc.or.jp/kids/kids_news/japan/item.html.

¹⁹³ Ministry of International Trade and Industry, "keizaisangyoushou tekougyou no genjyou to kadai sekai no sokouseisansui 経済産業省 鉄鋼業の現状と課題 世界の粗鋼生産推移," [MITI the current situation and issues of the steel industry], April 21, 2015, accessed January 27, 2019.

http://www.meti.go.jp/committee/kenkyukai/sansei/kaseguchikara/pdf/010_s03_02_03_01.pdf.

¹⁹⁴ Benjamin Elisha Sawe, "Top 10 Steel Producing Countries In The World," *World Atlas*, August 08, 2016, accessed January 27, 2019, <https://www.worldatlas.com/articles/the-top-10-steel-producing-countries-in-the-world.html>.

¹⁹⁵ *Steel Exports Report: Japan*, United States International Trade Administration, September 2018, accessed January 27, 2019, <https://www.trade.gov/steel/countries/pdfs/2018/q2/exports-japan.pdf>.

industry is considered an important sector of Japan's manufacturing industry as it is the base for other sectors of the manufacturing industry such as the machinery and auto industry.

The U.S. is the largest importer of steel in the world, importing around \$29 billion dollars worth of steel each year.¹⁹⁶ The U.S. in 2017 produced 81.6 million metric tons of steel, ranking fourth in steel production in the world. Around 140,000 people are employed in the steel sector today accounting for 0.06% of total U.S. employment.¹⁹⁷ Canada, South Korea, Mexico, Brazil, Russia are the five biggest exporters of steel to the United States. Globally, steel is mainly used in buildings and infrastructure, mechanical equipment, and automobiles.¹⁹⁸

Compared to steel, Japan is not a big producer of aluminum. They peaked at 1.19 million metric tons produced in 1977 and the whole industry declined due to the price of electricity increasing after two oil shocks. Japan only produces 6600 metric tons of aluminum per year now and is very reliant on imports, importing about 2.2 million tons per year.¹⁹⁹ But Japan owns one of the world's largest aluminum rolling companies in UACJ²⁰⁰ and Japan produces about 2.06 million metric tons per year of rolled aluminum.²⁰¹ 31,000 metric tons are exported to the U.S. out of the 203,853 metric tons exported in total.²⁰²

In terms of the aluminum industry, the U.S. imported about five million metric tons of aluminum in 2017, around \$13.6 billion worth of aluminum.²⁰³ The U.S. produced 785,000 metric tons of aluminum and exported 315,000 metric tons of aluminum. The U.S. is ranked ninth in aluminum production in the world and the industry employs about 160,000 people.²⁰⁴

Significance

The U.S. strategy with these tariffs is to increase jobs in the steel and aluminum producing sector. By putting tariffs on foreign made steel and aluminum, the U.S. steel and aluminum producing

¹⁹⁶ Meghan Keneally, "Key Facts about the US Steel and Aluminum Industries," *ABC News*, March 8, 2018, accessed January 27, 2019, <https://abcnews.go.com/beta-story-container/Business/key-facts-us-steel-aluminum-industries/story?id=53616380>.

¹⁹⁷ Keneally, "Key Facts."

¹⁹⁸ Alanna Petroff, "The Global Steel Industry by the Numbers," *CNN Money*, March 2, 2018, accessed January 27, 2019, <https://money.cnn.com/2018/03/02/news/economy/steel-industry-statistics-us-china-canada/index.html>.

¹⁹⁹ MITI, "keizaisangyoushou aluminum sangyou no genjyou to kadai taishou seiyaku case 経済産業省 アルミニウム産業の現状と課題 大正製薬ケース," [MITI the current situation and the issues of the aluminum industry], Accessed January 27, 2019 http://www.meti.go.jp/policy/nonferrous_metal/strategy/aluminium02.pdf.

²⁰⁰ Beethika Biswas, "Top Five Aluminium Rolling Companies in the World," *Alcircle*, November 26, 2016, <https://www.alcircle.com//news/top-five-aluminium-rolling-companies-in-the-world-26426>.

²⁰¹ Yuka Obayashi, "Japan's Aluminum Industry Calls for U.S. to Scrap Import Tariffs," *Reuters*, March 29, 2018, <https://www.reuters.com/article/us-japan-aluminium-idUSKBN1H517E>.

²⁰² Obayashi, "Japan's Aluminum Industry Calls for U.S. to Scrap Import Tariffs."

²⁰³ Keneally, "Key Facts."

²⁰⁴ Keneally, "Key Facts."

sectors are able to be price competitive in the U.S. market. In addition, the U.S. wants to pressure Japan to purchase more goods from the U.S. to minimize the trade deficit. But the tariffs put on Japanese steel and aluminum imports are simply not effective in achieving President Trump's goals. Even though the Japanese steel industry exports vast amounts of steel, Japanese steel accounts for only 5% of the total steel imported into the U.S. compared to 20% for Canadian steel.²⁰⁵ As for Japan's total steel exports, only 4% is exported to the U.S. That is, Japan and the U.S. are not major trade partners in terms of steel.²⁰⁶ The U.S. and Japan are not major trade partners in aluminum either.²⁰⁷ Simply put, the tariffs President Trump has put forth have only a marginal effect on the Japanese economy and they are also very ineffective when considering the United States' diplomatic relations with Japan.

Despite President Trump's attempt to decrease the trade deficit, the steel and aluminum tariff is having a negative effect on the U.S. economy. The reasoning behind this is that with tariffs put in place, the price of steel in the U.S. market is increasing due to the increase in price of foreign steel. The higher prices for steel are hurting other industries reliant on cheap steel, mainly the manufacturing sector. The tariffs have already affected the domestic automobile industry as G.M. announced the cut of 14,000 jobs due to the closure of multiple plants, which they attributed in part to rising production costs from the steel tariffs.²⁰⁸

The manufacturing jobs that are negatively affected by the steel tariff outnumber steel producing sector jobs by 80 to 1.²⁰⁹ In the case of the 2002 Bush steel tariffs, more people lost jobs than the total number of people employed in the steel industry. 200,000 jobs were lost in the steel consuming sector, compared to the total employment at the time of 187,500 jobs in the steel producing sector.²¹⁰ For President Trump's tariffs, the Trade Partnership estimates that these tariffs will create about 33,464 jobs in steel and aluminum producing industries but cost about 179,334 jobs in other sectors. In summary, they expect that five jobs will be lost for every one job gained.²¹¹ Tariffs don't

²⁰⁵ *Steel Imports Report: United States*, United States International Trade Administration, September 2018, accessed January 27, 2019, <https://www.trade.gov/steel/countries/pdfs/imports-us.pdf>.

²⁰⁶ *Steel Exports Report: Japan*.

²⁰⁷ Daniel Workman, "US Aluminum Imports by Supplying Country," *World's Top Exports*, December 29, 2018, <http://www.worldstopexports.com/us-aluminum-imports-by-supplying-country/>.

²⁰⁸ Neal E Boudette, "G.M. to Idle Plants and Cut Thousands of Jobs as Sales Slow," *The New York Times*, November 26, 2018, <https://www.nytimes.com/2018/11/26/business/general-motors-cutbacks.html>.

²⁰⁹ Lydia Cox, and Kadee Russ, "Will Steel Tariffs Put U.S. Jobs at Risk?" *Econofact*, November 01, 2018, <https://econofact.org/will-steel-tariffs-put-u-s-jobs-at-risk>.

²¹⁰ "President Donald Trump Wants Tariffs on Steel and Aluminium," *The Economist*, March 02, 2018, <https://www.economist.com/finance-and-economics/2018/03/02/president-donald-trump-wants-tariffs-on-steel-and-aluminium>.

²¹¹ Meghan Keneally, "Non-Partisan Group Predicts Trump Tariffs Would Cost 146,000 Jobs," *ABC News Network*, March 6, 2018.

increase the total number of jobs but rather just rearrange them.²¹² Taking into consideration the undesirable effect the tariffs will have on the U.S. economy and also considering the negative effects it will have on the United States' relationship with Japan, the tariffs should be removed immediately.

Free Trade Agreement

If an FTA is signed between the U.S., Japan, and South Korea, it is hard to envision a scenario where the U.S. and Japan become major trade partners in steel and aluminum. But with South Korea involved, both the U.S. and Japan can gain access to cheaper steel regardless of their lack of trade with each other. South Korea is a major exporter of steel to both nations,²¹³ with 13% of steel exported from Korea sent to Japan and 11% being exported to the U.S.²¹⁴ Overall an FTA would not affect the trade relationship regarding steel and aluminum between Japan and the U.S., but the removal of tariffs would show faith and positive outlook for trade in other industries.

Automobiles

Background

Rather than the steel and aluminum tariffs, what would affect Japan most is a tariff on automobiles. President Trump has floated the idea of placing 15-35% tariffs on Japanese automobiles in order to retaliate for Japan's trade surplus with the U.S.,²¹⁵ but he has delayed this decision while dealing with China trade negotiations. Automobiles are a large part of the Japanese economy. In 2017 Japan exported a total of \$698 billion worth of goods,²¹⁶ with auto exports accounting for 15% of this total at about \$107 billion. The second largest export was integrated circuits at \$36.5 billion, around a third of the total value of cars exported, proving how important automobiles are to Japan's economy.²¹⁷ Japan's top three export markets for automobiles in 2017 were the U.S., China, and Australia, with the U.S. importing 40% of Japan's total automobile exports.²¹⁸ Now looking at the big picture, auto exports to the U.S. make up about 31% of total Japanese exports to the U.S., about \$40 billion in value out of

²¹² Sawyer, 128.

²¹³ *Steel Imports Report: South Korea*, United States - International Trade Administration, March 2018, Accessed January 27, 2019, <https://www.trade.gov/steel/countries/pdfs/2017/annual/exports-korea.pdf>

²¹⁴ *Steel Imports Report: South Korea*.

²¹⁵ Motoko Rich, "Japan's Embrace of Bilateral Trade Talks with U.S. Spares It From Tariffs," *The New York Times*, September 27, 2018, <https://www.nytimes.com/2018/09/27/world/asia/japan-trump-trade-talks-auto-tariffs.html>.

²¹⁶ "Trade Profiles: Japan," World Trade Organization, accessed March 04, 2019, <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=S&Country=JP>.

²¹⁷ "Nihon no omona yushutsunyuhin JFTC kids site JFTC ipan shadan houjinn nihon bouekikai," 日本の主な輸出入品.

²¹⁸ "Export Destinations of Cars from Japan (2017)," The Observatory of Economic Complexity, accessed February 13, 2019, http://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/jpn/show/8703/2017/.

\$130 billion exported to the U.S. in 2016.²¹⁹ The automobile industry and their exports to the U.S. are a very integral part of the Japanese economy.

The U.S. is also a major exporter of cars. In 2017 they exported around \$56 billion in value, ranking third in the world in total car exports.²²⁰ The United States' top three export markets for automobiles in 2017 were Canada, China, and Germany. Japan is ninth, importing about 1.4% of total U.S. auto exports around \$784 million in value.²²¹ The U.S. is the largest importer of cars in the world, importing \$179 billion in value in 2017, three times more than the second largest car importer in the world.²²² Out of the \$179 billion, Japanese automobiles were responsible for 23% of imports, second to Canada, which exported around \$44 billion worth of automobiles to the U.S.

Significance

If 25% tariffs were placed on Japanese cars, the Japanese economy would take a \$5 billion hit which is equivalent to around 0.1% of their GDP.²²³ Manufacturing costs could increase by about \$8.6 billion. If those costs affected the prices of the Japanese automobiles, SMBC Nikko Securities believes that car exports from Japan would decline by 200,000 units, which would cut profits by about 2.2%.²²⁴ The idea of placing a 25% tariff on one of the United States' key allies' most important industries is not in the national interest of the United States. Also, since many of Japan's automobile companies have plants in the U.S., which employ U.S. citizens, the idea of tariffs makes even less sense. Toyota, for example, has invested approximately \$10 billion in its U.S. operations in the last five years with the same amount to follow for the next five years as well, helping Toyota's Indiana factory add 400 jobs starting 2019.²²⁵ Moreover, the number of Japanese brand cars produced in the U.S. in 2015 stood at 3.9 million compared to 300,000 in 1985 and 75% of the Japanese brand automobiles sold in the U.S. are manufactured in North America.²²⁶ The tariffs will not only hurt Japan's economy but will also have a negative effect on the U.S. economy. Rather than placing tariffs on Japan, a key ally in East Asia, the U.S.

²¹⁹ "Products That Japan Exports to the United States (2016)," OEC - Japan Exports, Imports, and Trade Partners, accessed January 28, 2019, https://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/jpn/usa/show/2016/.

²²⁰ "Import Origins of Cars to the United States (2017)," The Observatory of Economic Complexity, accessed February 13, 2019, http://atlas.media.mit.edu/en/visualize/tree_map/hs92/import/usa/show/8703/2017/.

²²¹ "Import Origins of Cars to the United States."

²²² Daniel Workman, "Car Imports by Country," World's Top Exports, February 1, 2019, <http://www.worldstopexports.com/cars-imports-by-country/>.

²²³ Daniel Hurst, "A Brewing US-Japan Trade War?," *The Diplomat*, June 7, 2018, <https://thediplomat.com/2018/06/a-brewing-us-japan-trade-war/>.

²²⁴ Rich, "Japan's Embrace of Bilateral Trade Talks with U.S. Spares It From Tariffs."

²²⁵ "From Rival to Ally: Japan's American Evolution," *JapanGov.*, accessed February 2, 2019, <https://www.japan.go.jp/investinamerica/greater-than-the-sum-of-the-parts.html>.

²²⁶ "From Rival to Ally."

should look to sign an FTA to strengthen their relationship and support economic growth in both nations.

Free Trade Agreement

If an FTA were to be signed between the U.S. and Japan, the U.S. must assess whether reciprocity regarding automobile trade is possible between the two nations. One thing the U.S. must consider is whether or not the lack of competitiveness of U.S. automobile companies is due to a comparative disadvantage or because of the non-tariff barriers that exist. One of the non-tariff barriers that exists in Japan is the *shaken* system. The *shaken* system is a motor vehicle inspection program in Japan. It is considered a non-tariff barrier as the system has a set of standards that all Japanese car companies comply to. But foreign automobiles do not often conform to the standards, leading to additional fees for owners who own foreign cars or car parts that do not comply to the *shaken*.²²⁷ But even if this non-tariff barrier is removed, considering the fact that the Japanese drive on the left-hand side of the road and prefer small cars, it is not realistic for U.S. automobile makers to be competitive in the Japanese auto market. Because it is highly unlikely that Japan will import many U.S. cars, the U.S. should encourage Japanese firms to increase foreign direct investment in the U.S. auto industry. Japan's FDI in 2017 was \$469 billion and sales of services in the U.S. by Japan-owned firms was \$152.8 billion.²²⁸ Autos make up about a quarter of Japanese investments in the U.S. and as previously mentioned, many Japanese brand automobiles are manufactured in the U.S. and thus contribute to U.S. employment. Overall, Japan's FDI has directly led to the creation of 840,000 U.S. jobs.²²⁹ The creation of an FTA will allow for more FDI between the two nations and be beneficial for both economies, creating jobs, increasing income, and spurring economic growth. With an FTA, Japan will be able to continue to have access to the U.S. automobile market and the U.S. market as a whole. In return the U.S. should continue to receive FDI from Japanese auto companies, allowing economic growth in both nations. The U.S. should also push Japan to purchase other very competitive U.S. products such as agriculture.

²²⁷Frank Gibney, *Unlocking the Bureaucrats Kingdom: Deregulation and the Japanese Economy* (Washington, D.C.: Brookings Institution Press, 1998).

²²⁸ "Japan," *Office of the United States Trade Representative*.

²²⁹ "From Rival to Ally."

Agriculture

Background

Agriculture is a very small part of the Japanese economy. In 2016, the agricultural sector produced around \$47 billion in value which was about 0.97% of total GDP.²³⁰ Rice is Japan's most important crop followed by others such as soybeans and wheat.²³¹ Farmland is very scarce in Japan, with only 12% of the total area in Japan considered arable land.²³² In the U.S., the agricultural sector produced around \$205 billion in value in 2016.²³³ The main crops in the U.S. are corn and soybeans²³⁴ and 16.6% of U.S. land area is considered arable.²³⁵

Significance

If an FTA is reached with Japan, they would represent a major market for the U.S. in terms of agriculture. Japan is suffering from an aging population and a shortage of farmers leading Japan to lack self-sufficiency in the agricultural sector.²³⁶ In 2017, Japan had a 38% food self-sufficiency rate,²³⁷ a very low figure compared to other developed nations.²³⁸ In 2015, the number of people working in the agricultural field was 2 million, a 60% drop from 5.42 million in 1985. In addition to the decrease in the farming population, the average age of farmers has increased: 63.5% are age 65 or older, compared to 20% in 1985.²³⁹ With the aging population and the lack of farmers, Japan's agricultural industry does not have a bright outlook and will need to import more food. Also, because Japan is at a comparative disadvantage in agriculture due to their lack of land,²⁴⁰ the U.S. will be able to sell more in this large

²³⁰ "GDP kokunaisouseisan ni kansuru toukei nourinsuisanshou GDP (国内総生産)に関する統計：農林水産省," [Stats about GDP: Ministry of Agriculture, Forestry, and Fisheries], Accessed February 27, 2019, <http://www.maff.go.jp/j/tokei/sihyo/data/01.html>.

²³¹ USDA, "Japan," Trip Report - Japan Agricultural Situation, August 17, 2012, <https://ipad.fas.usda.gov/highlights/2012/08/Japantrip/>.

²³² USDA, "Japan."

²³³ IMF, "Report for Selected Countries and Subjects," April 2017, <https://www.imf.org/external/pubs/>.

²³⁴ USDA, "Crop Values Final Estimates 2007-2012," 11/03/2014, https://downloads.usda.library.cornell.edu/usda-esmis/cropvalest_Crop_Values_-_Final_Estimates__2007-12.pdf.

²³⁵ "United States of America Arable Land as a Share of Land Area, 1960-2018 - Knoema.Com," Knoema, accessed February 27, 2019, <https://knoema.com//atlas/United-States-of-America/topics/Land-Use/Area>.

²³⁶ "Japan's Farming Population Rapidly Aging and Decreasing," 2018, *Nippon*, July 3, 2018, <https://www.nippon.com/en/features/h00227/japan's-farming-population-rapidly-aging-and-decreasing.html>.

²³⁷ "Nihon no shokuryou jikyuuritsu nourisuisanshou 日本の食料自給率：農林水産省," [Japan's food self sufficiency: Ministry of Agriculture, Forestry and Fisheries], accessed February 13, 2019, http://www.maff.go.jp/j/zyukyu/zikyu_ritu/012.html.

²³⁸ "Toward a securing stable food supply" n.d, accessed February 12, 2019, http://www.maff.go.jp/e/annual_report/2010/pdf/e_1.pdf.

²³⁹ "Japan's Farming Population Rapidly Aging and Decreasing."

²⁴⁰ Kimiyoshi Tsukazaki, 塚崎公義, "nouka ga hitodebusoku nara, hojyokin wo yamete nousanbutsu wo yunyu shiyou 農家が人手不足なら、補助金をやめて農産物を輸入しよう," [If we lack the number of farmers, lets import more agricultural products], *HuffPost Japan*, August 14, 2018, accessed January 28, 2019, https://www.huffingtonpost.jp/sharescafe-online/agriculture-20180814_a_23496784/.

market. In contrast to Japan, which has low food self-sufficiency, the U.S. was reported to have a food self-sufficiency rate of 124% in 2010.²⁴¹ The agricultural trade industry in the U.S. provided a positive trade balance in 2016, exporting around \$135.5 billion worth of U.S. agricultural products to the world.²⁴²

Free Trade Agreement

If Japan is willing to lower their tariffs on agricultural products to the level of the TPP or lower, it would be a major boon for the United States. In 2015 Japan imported around \$60 billion worth of produce and 24.5% of that was from the U.S., which was more than any other nation in the world.²⁴³ Even though Japan already imports about \$15 billion worth of agricultural products from the U.S., there is more room for growth. Japan imported the second most amount of produce from China at \$7.5 billion.²⁴⁴ The removal of tariffs with an FTA would allow U.S. agricultural products the opportunity to replace Chinese agricultural products in the Japanese market, which could allow the U.S. to increase its revenue by cutting into China's 12.4% market share of Japanese agricultural imports.²⁴⁵ This would allow the U.S. to expand its market share within Japanese produce imports and simultaneously weaken China's grip on the Japanese produce market.

Energy

Background

In addition to agriculture, if an FTA is reached with Japan, Japan represents a major market for the booming U.S. energy industry. Currently Japan is reliant on fossil fuels to provide energy. Coal, oil, and liquified natural gas (LNG) are Japan's top three sources of energy making up about 89% of the total.²⁴⁶ Prior to the Fukushima Nuclear accident, nuclear power made up around 11% of Japan's energy but since the accident, the use of nuclear power has fallen to less than 1%, leading to increased dependency on LNG.²⁴⁷

²⁴¹ "Toward a securing stable food supply."

²⁴² "Fast Facts About Agriculture - The Voice of Agriculture - American Farm Bureau Federation," accessed February 14, 2019, <https://www.fb.org/newsroom/fast-facts>.

²⁴³ "Yunyu_2016_c.Pdf," 2016, Accessed February 2, 2019, http://www.maff.go.jp/j/zyukyu/anpo/pdf/yunyu_2016_c.pdf.

²⁴⁴ "Yunyu_2016."

²⁴⁵ "Yunyu_2016."

²⁴⁶ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI)", 2017, accessed January 27, 2019, http://www.enecho.meti.go.jp/en/category/brochures/pdf/japan_energy_2017.pdf.

²⁴⁷ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI), 2017."

Significance

Japan is very reliant on imports for energy, with their energy self-sufficiency at 7.4%, one spot above Luxembourg.²⁴⁸ Prior to the Great East Japan earthquake of 2011 and the Fukushima nuclear accident, Japan had an energy self-sufficiency of 20%.²⁴⁹ But with strong public opposition towards nuclear power in Japan it is unlikely that Japan will rely on nuclear power for their energy source in the long run. Also, with a country short on natural resources it is highly unlikely for Japan to have a high energy self-sufficiency in the future. In contrast, the U.S. has an energy self-sufficiency of 92.2% and is a very resource rich country.²⁵⁰ As of 2017, the U.S. exported about 6.38 million barrels of oil per day, with 5% of those exports going to Japan.²⁵¹ Also, with the discovery of shale gas at the turn of the 21st century and the abundance of natural gases, the U.S. should expect to have a strong energy supply for the foreseeable future.²⁵²

Free Trade Agreement

Since the U.S. is not in the top ten in terms of countries that Japan imports crude oil and liquified natural gas from, there is a lot of room for growth in terms of trade and the FTA should only continue to assist in expanding the U.S. market share within Japan's energy industry.²⁵³ Research on exporting of natural gas and its effects on the economy has shown that exporting natural gas would tremendously benefit the U.S. economy.²⁵⁴ In 2015, Rice University's Center for Energy Studies and Oxford Economics found that increasing the amount of natural gas exported, in this case 12 billion cubic feet per day to 20 billion cubic feet per day, showed that the GDP would increase from between \$7 billion to \$20 billion annually from 2026-2040.²⁵⁵ Overall the projected benefits would include an increase in export revenue, GDP, and jobs.²⁵⁶ With its abundant energy supply, the U.S. would be able to sell from a surplus and Japan would be able to solve their energy problem through purchasing cheap energy from the U.S., allowing the trade to be a win for both sides.

²⁴⁸ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI), 2017."

²⁴⁹ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI)", 2016, accessed January 27, 2019, http://www.enecho.meti.go.jp/en/category/brochures/pdf/japan_energy_2016.pdf.

²⁵⁰ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI), 2017."

²⁵¹ "How Much Petroleum Does the United States Import and Export? - FAQ," U.S. Energy Information Administration (EIA)," accessed February 02, 2019, <https://www.eia.gov/tools/faqs/faq.php?id=727>.

²⁵² Paul Stevens, "The 'Shale Gas Revolution': Developments and Changes," Chatham House, December 07, 2018, accessed January 28, 2019, <https://www.chathamhouse.org/publications/papers/view/185311>.

²⁵³ METI, "Japan's Energy, Ministry of Economy, Trade and Industry (METI), 2017."

²⁵⁴ Nicolas Loris, "Removing Restrictions on Liquid Natural Gas Exports: A Gift to the U.S. and Global Economies," The Heritage Foundation, July 27, 2017, <https://heritage.org/energy-economics/removing-restrictions-liquid-natural-gas-exports-gift-the-us-and-global>.

²⁵⁵ Loris, "Removing Restrictions on Liquid Natural Gas Exports: A Gift to the U.S. and Global Economies."

²⁵⁶ Loris, "Removing Restrictions on Liquid Natural Gas Exports: A Gift to the U.S. and Global Economies."

Conclusion

The primary concern for many in the U.S. regarding FTAs in general is that jobs may be outsourced to a foreign nation. However, Japan is not a developing nation in which wages are significantly lower than the U.S., with the average monthly income in Japan at \$2950 USD,²⁵⁷ compared to the U.S. average monthly income of \$3714. Also, to reconsider the idea that globalization and FTAs reduce the amount of jobs, one must consider the presence of automation. A staggering 5.6 million manufacturing jobs were lost between 2000-2010 in the U.S. however, 85% of that was due to automation.²⁵⁸ In addition, results show that output is increasing as employment decreases,²⁵⁹ a testament to technological advancement and automation in the manufacturing sector. It is self-defeating not to join into an FTA because of concerns of losing jobs, when in reality those jobs are lost to automation and technology, not to foreign nations. Moreover, many of the industries outlined such as automobiles, agriculture, and energy would most likely lead to an increase in the number of jobs due to the signing of an FTA with Japan.

The signing of the FTA would create positive economic growth through trade for both the U.S. and Japan. The U.S. would be able to increase exports to Japan in the agricultural and energy sector, increasing revenue and employment in those sectors. Also, the U.S. will likely receive increased amounts of FDI in the automobile industry from Japan promoting economic growth. Japan would also be able to continue to export automobiles to the U.S. while purchasing energy and agricultural products at a cheap price. But most importantly the U.S. will be able to assure that Japan continues to be a close ally despite the rise of China within the world order. The U.S. needs to swiftly come to an agreement with Japan and South Korea on a trilateral trade agreement before the three Asian nations sign one of their own. In order for a continued stable U.S. presence in East Asia, the U.S. needs to build even stronger diplomatic relations through economic partnerships with Japan and South Korea in order to contain China. It is counterproductive to be creating conflicts with our key allies in the region.

Policy Recommendations

- Immediate removal of steel and aluminum tariffs in order to prevent negative relations with Japan and isolation of the U.S. in East Asia.

²⁵⁷ "Japan Average Monthly Wages - 2019," n.d., Accessed February 2, 2019. <https://tradingeconomics.com/japan/wages>.

²⁵⁸ Federica Cocco, "Most US Manufacturing Jobs Lost to Technology, Not Trade," *Financial Times*, December 02, 2016, accessed January 28, 2019, <https://www.ft.com/content/dec677c0-b7e6-11e6-ba85-95d1533d9a62>.

²⁵⁹ Cocco, "Most US Manufacturing Jobs Lost to Technology, Not Trade."

- Continued discussion about increasing FDI within the automobile industry from Japan in order to create U.S. jobs, with the goal of promoting economic growth within the U.S.
- Establish a trilateral agreement among the U.S., Japan, and South Korea focused on increased FDI, increased trade through the elimination of trade barriers especially in the agricultural and energy sector, to promote continued economic growth in both nations and contain China's influence in the region.

U.S. - KOREA TRADE RELATIONS

Jinyong Um

Introduction

The United States considered South Korea as a lynchpin for managing stability in the Asia-Pacific. This metaphor was used by former President Obama to emphasize the importance of the U.S.-South Korea alliance. This relationship now requires careful coordination and effective management to navigate new challenges such as shifts in the geopolitical environment resulting from China's rising power and South Korea's evolving conception of itself as a middle power.²⁶⁰ The use of the metaphor was soon eclipsed as the inauguration of new presidents of both countries changed the character of U.S. and South Korea relations. This is exemplified in President Moon's implementation of a foreign policy that radically departs from the United States' security plan in the East Asian region.

The beginning of this change started in October 31st, 2017 as a result of a discussion between South Korea and China. South Korea has defined their stance as the "3-Nos"²⁶¹ - no missile defense, no additional Terminal High Altitude Defense systems (THAAD), and no to a trilateral alliance between the U.S., Japan, and South Korea. The U.S. was dissatisfied and worried about South Korea's new stance and questioned the identity of the Moon administration as a diplomatic partner. President Trump's November visit to South Korea seemed to have restored relations, however, President Moon's remark in December that, "China and South Korea should jointly keep promoting the community of shared future," sounded like Korea is "leaning toward China,"²⁶² to a U.S. audience. The U.S.-South Korea relationship has not only changed diplomatically, their economic partnership has been tested since the beginning of 2018 as Trump's protectionist policies came into effect.

On January 23, 2018, President Trump announced his decision to impose safeguard tariffs on imported large residential washing machines and imported solar cells and modules. South Korean companies, LG and Samsung, became subject to the tariffs. President Trump pressured them to build

²⁶⁰ "The U.S.-ROK Alliance: Lynchpin for Managing Stability in the Asia-Pacific," Council on Foreign Relations, accessed February 28, 2019, <https://www.cfr.org/project/us-rok-alliance-lynchpin-managing-stability-asia-pacific>.

²⁶¹ "Three Goals - Moon Jae-In's Policy on the Korean Peninsula Policy Issues," accessed February 28, 2019, https://www.unikorea.go.kr/eng_unikorea/policyIssues/koreanpeninsula/goals/.

²⁶² Seung Hyok Lee and Wooyeal Paik, "Is South Korea Leaning Toward China? Questioning the Contemporary Application of the Japanese Narrative About the Historical Korean Peninsula-China Linkage," 2018, *Pacific Focus* 33 (2): 237-59. <https://doi.org/10.1111/pafo.12117>.

their factories in the U.S.²⁶³ Also, South Korea became a subject to the March 2018 tariffs that the U.S. imposed: 25% on steel and 10% on aluminum.²⁶⁴ South Korea tried to defend their steel industries from the sudden imposition of tariffs, and the U.S. agreed to grant a revision of the KORUS FTA. The series of diplomatic and trade conflicts between the U.S. and South Korea has created tensions in their alliance. This relationship may be tested further with potential tariffs on Korean automobiles.

Though the South Korean government has different approaches to dealing with China and North Korea, the U.S. should not let the U.S.-South Korea alliance become weaker, and instead should maintain a positive relationship with South Korea by strengthening economic ties. Moreover, the U.S. should seek a way to establish a consolidated relationship with South Korea and Japan altogether, and foster a trilateral trade agreement as the solution. Stronger economic interdependence of the three countries would put the U.S. in a stronger position to exercise power in the region.

Trade Deficit

President Trump's inauguration brought protectionism back on the U.S. policy agenda. He ordered the USTR to enact tariffs on the imported goods of major U.S. allies, including South Korea. South Korea is one of the United States' largest trading partner, ranked sixth in total trade with a value of \$118.57 billion.²⁶⁵ While Trump implemented tariffs to balance out the \$17 billion trade deficit with South Korea, the tariffs only resulted in hurting U.S.-Korean relations. It is more critical than ever for the U.S. to maintain positive trade relations with South Korea, especially in the midst of a trade war with China.

Safeguard Tariffs on Washing Machines

As mentioned above, the Trump administration's policy agenda is mainly built upon protectionism. The agenda includes a revival of manufacturing industries, which although they are significantly declining in the U.S., are performing well in other countries. China, Taiwan, South Korea, and Japan took huge advantages from exporting manufactured goods to the United States to boost their economies. The washing machine market is one of the manufacturing industries that South Korean companies have a high U.S. market share. The USTR has decided to regulate South Korean companies to

²⁶³ "Teureompeu, 'setakgi seipeugadeu' seomyeonghameyo 'iyongdanghaji anheul geot" 트럼프, '세탁기 세이프가드' 서명하며 '이용당하지 않을 것, [Trump said, The United States will not be taken advantage of anymore,]" January 24, 2018, <http://www.hani.co.kr/arti/international/america/829191.html>.

²⁶⁴ "Trump Formally Orders Tariffs On Steel, Aluminum Imports," *NPR*, accessed February 28, 2019, <https://www.npr.org/2018/03/08/trump-expected-to-formally-order-tariffs-on-steel-aluminum-imports>.

²⁶⁵ "U.S. Trade with South Korea Tops \$119 Billion through November 2018," n.d., accessed February 28, 2019, <https://www.ustradenumbers.com/country/south-korea/>.

give an advantage to U.S. washing machine manufacturers, such as Whirlpool, in an attempt to revive the manufacturing industry.

U.S. Trade Representative Robert Lighthizer said in a press release on January 23, 2018 that President Trump has approved a safeguard tariff for imported washing machines and solar products.²⁶⁶ A safeguard tariff refers to a trade barrier that allows one country to regulate imports from another country through tariff hikes and restrictions in the event of serious damage to their businesses due to surging imports of certain items. President Trump said, "When we do this, a lot of manufacturers will be coming to the United States to build washing machines and also solar. The United States will not be taken advantage of anymore."²⁶⁷ President Trump says the U.S. is being taken advantage of because countries that trade with the U.S. can export their manufactured goods, but the U.S. is not able to reciprocate. Trump wants to protect U.S. companies, or at least move South Korean companies' factories to the U.S. to create more jobs.

However, contrary to the President's expectation, the impact of the safeguard tariffs could slow down the relocation of Korean companies to the U.S. The tariffs on imported washing machines started at 20% in the first year and are decreasing to 18% and 16% in the second and third year. Also, 50%, 45%, and 40% tariffs are imposed on units above a 1.2 million import quota, in the first, second, and third year. To avoid safeguard tariffs, the two main South Korean washing machine manufacturers, Samsung and LG, have moved their factories to build products within the U.S. However, the companies found that relocation of their factories was not beneficial because the production costs of the U.S. plant were higher than expected, ultimately costing similar to the added expenses of the tariffs. Therefore, the safeguard tariffs have only discouraged South Korean companies from moving more factories to the U.S.

The U.S. washing machine manufacturer, Whirlpool, did not achieve any positive result out of a safeguard tariff either. South Korean washing machine manufacturers have slightly improved performance in sales after the imposition in February 2018. In the first half of 2017, Samsung and LG held market shares of 17% and 14% respectively, and Whirlpool had a 16.3% market share. However, Samsung and LG's market shares have increased to 19.1% and 17.2% and Whirlpool's market share dropped to 15.7%, in the first half of 2018. Whirlpool's operating profit also has decreased. Its operating

²⁶⁶ "Miguk, seipeugadeu baldong...samseong-ik setakgi gagyek 20%isang oreunda," 미국, 세이프가드 발동...삼성·LG 세탁기 가격 20%이상 오른다, [The U.S. imposes Safeguard tariffs, Samsung·LG Washing machine price will go up more than 20%,] *Hani*, January 23, 2018, <http://www.hani.co.kr/arti/international/america/828939.html>.

²⁶⁷ "Remarks by President Trump at Signing of Section 201 Actions," The White House, accessed February 28, 2019, <https://www.whitehouse.gov/briefings-statements/remarks-president-trump-signing-section-201-actions/>.

profit in the first half of 2018 was \$210 million, which is down 24% from the same period in 2017.²⁶⁸ In conclusion, the imposition of safeguard tariffs on the imported washing machine is not helping the U.S. economy as U.S. manufacturer performance is not increased and U.S. consumers are paying higher prices.

Automobiles

The automobile industry is one of the most important industries to South Korea's economy, responsible for 12% of total employment and 13% of total manufacturing industries.²⁶⁹ In 2018, South Korea exported around \$67.8 billion worth of goods, with auto exports accounting for 18% of this total at around \$12.4 billion.²⁷⁰ President Trump has threatened the auto industry with potential tariffs of up to 25% on imported automobiles and auto parts. The South Korean government asked the U.S. to exclude Korean-made automobiles from the list of potential tariffs, but the U.S. has not given a definite answer yet.

Tariffs on automobiles and auto parts are another measure by President Trump to reduce the trade deficit and protect U.S. industries. However, the U.S. tariffs on imported cars may have a negative impact on U.S. auto consumption and exports as well. The major automobile manufacturers and auto parts makers carry out production in many facilities in different parts of the world. When production costs rise on either side of this fragmented global network, it creates a chain of synergies that affect the other side. The U.S. automobile industry is not exempt from such a ripple effect. U.S. cars require multiple parts from other countries which cross borders several times, such that tariffs on auto parts eventually will increase the price of the cars manufactured by U.S. companies.

The Korea International Trade Association analyzed that consumer prices for cars manufactured and sold in the U.S. are expected to rise 11% from \$27,321 to \$30,346 per vehicle due to 25% tariffs on auto parts. In the case of imported vehicles from South Korea, the average consumer price is expected to rise 18% from \$26,651 to \$32,882.²⁷¹ Although, in the short run, higher prices for imported cars may

²⁶⁸ "Mi setakgi gwanseedo 1~2wi jari jikin samseong-ik" 美 세탁기 관세에도 1~2위 자리 지킨 삼성·LG, [Samsung-LG defends first and second place in despite of the U.S. Washing machine tariffs], *Asia Economy* 아시아경제, October 28, 2018, <http://www.asiae.co.kr/news/view.htm?idxno=2018102810503808064>.

²⁶⁹ Sogang University Business Professor Yongjin Jim 교수김용진 서강대학교 경영학과, "Hanguk jadongchasaneop saengjoneul wihan daseot gaji daean" 한국 자동차산업 생존을 위한 다섯 가지 대안 [Five Recommendations for Survival of the Korean Automotive Industry], November 26, 2018, <http://www.pressian.com/news/article.html?no=218792>.

²⁷⁰ "U.S. Trade with South Korea Tops \$119 Billion through November 2018."

²⁷¹ "Muyeokhyeophoe 'migugui suipcha gogwase bugwahameon hanguk suchul ↓' 무역협회 '미국의 수입차 고관세 부과하면 한국 수출 ↓', [The Korea Trade Association said, 'If the U.S. imposes a high tariff on imported cars, its export rate would go down], *에브리뉴스 Every News*, October 02, 2018, <http://www.everynews.co.kr/news/articleView.html?idxno=35501>.

shift consumer demand from imported cars to the cars manufactured in the U.S., these domestically manufactured cars will be less competitive in the mid- to long-term as overseas production costs increase.

In addition, The Peterson Economic Research Institute predicted that if other countries retaliate with tariffs on the same products, production would fall 4%, 624,000 U.S. jobs would be lost, and 5% of the workforce in auto and auto parts industries would be displaced.²⁷²

Foreign Direct Investment

Company Relocation and R&D Investment Overseas

Similar to Trump's safeguard tariffs, the administration is trying to create more domestic jobs through relocation of foreign companies into the United States. This is an effective strategy to use on South Korean companies. These companies have been rushing to enter foreign markets, creating 2,860,000 manufacturing jobs, and an overall total of 3,384,000 jobs outside South Korea as of 2017.²⁷³ For example, the opening of Hankook Tire's first U.S. factory in March 2017 hired 1,200 employees to facilitate the production of 1.4 million tires. Kia Motors' construction of its Mexico plant in 2016 also hired 15,000 workers.²⁷⁴

South Korean firms are establishing a presence in foreign markets for a multitude of reasons. Kia's plant in Mexico was encouraged due to financial incentives from the Mexican government, such as free rent of 5,000,000 square meters of land and a 10-year corporate tax exemption. Hankook Tire, on the other hand, sought to avoid the potential loss from the Trump administration's protectionist policies by producing in the U.S.

These incentivizing policies, as practiced by the Mexican government, can attract South Korean companies to bring more factories to the U.S., creating jobs and boosting the economy. However, the U.S. can argue that the amount of taxes paid by South Korean companies for their overseas operations is

²⁷² "Trump's Proposed Auto Tariffs Would Throw US Automakers and Workers Under the Bus," *PIIE*, May 31, 2018, <https://piie.com/trade-investment-policy-watch/trumps-proposed-auto-tariffs-would-throw-us-automakers-and->

²⁷³ "Haeoenagan mi gieop, hyeonji inryeok 338man myeong... guknae yuteonhamyeon?" 해외나간 韓 기업, 현지 인력 338만 명... 국내 유턴하면? [Korean companies overseas, with 3.38 million local employees... What if we make a domestic U-turn?], Korea Trade Association 한국경제연구원, accessed February 28, 2019, http://www.keri.org/web/www/news_02?p_p_id=EXT_BBS&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&_EXT_BBS_struts_action=%2Fext%2Fbbs%2Fview_message&_EXT_BBS_messageId=353594.

²⁷⁴ "Guknae gieop juljuri haeoe ijeon...gyujepihae iljari `eksodeoseu` " 국내 기업 줄줄이 해외 이전... 규제피해 일자리 `엑소더스`, [Domestic companies continue to move overseas... Job 'Exodus' to avoid regulation], *MK News*, accessed February 28, 2019, <http://news.mk.co.kr/newsRead.php?year=2017&no=298971>.

too little compared to the profits they make. Samsung and Hankook Tire have made around 90%²⁷⁵ of their profits overseas yet only paid 6%²⁷⁶ of their total taxes to foreign governments.

In addition, South Korea's spending on research and development may benefit U.S. employees if the companies build R&D facilities in the United States. According to data released by the OECD in 2014, South Korea has seen the fastest growth in R&D expenditures among OECD countries over the last decade.²⁷⁷ South Korea's spending on R&D has soared to 4.36% of its GDP, more than any other country in the world and double that of China and the European Union.²⁷⁸ However, the outcome of South Korea's R&D does not reflect the amount of spending. According to the Hyundai Research Institute, R&D productivity in Korean companies in 2012 was measured to be 1.8%, which is only one-sixth of the 10.83% of U.S. companies.²⁷⁹ Also, South Korea is ranked twelfth in the overall number of papers published with the Science Index Citation, but the papers' average impact factor, which is frequently used as a proxy for the relative importance of a paper, is only ranked 32nd. This is far behind the United States', ranked seventh.²⁸⁰ This further indicates room for improvement within South Korean R&D. The U.S. should use their international reputation as a leader in R&D to attract further South Korean FDI.

Mergers and Acquisitions of Semiconductor Manufacturers

Chinese capital is making deep inroads into the South Korean semiconductor manufacturing industry, causing global concern. As China rapidly grows and becomes an economic powerhouse, numerous companies from all over the world, regardless of advanced or developing countries, have been purchased by Chinese buyers. As the companies are taken back to China, technology is transferred as well. South Korea is no exception. Currently, the number of mergers and acquisitions (M&As), in which a Korean firm is either merged with or fully acquired by a Chinese company, is increasing at an

²⁷⁵ "Hanguktaieo, suyobujine mi-yureop gongjang jeungseol boryu" 한국타이어, 수요부진에 미·유럽 공장 증설 보류, [Korea Tire Company Holds Expansion of U.S. and European Factories Due to Poor Demand], *MK News*, accessed February 28, 2019, <http://news.mk.co.kr/newsRead.php?year=2019&no=43561>.

²⁷⁶ "Samseongjeonja, maechul 87% 'haeoeseo'...segeum 81%neun 'guknae,'" 삼성전자, 매출 87% '해외에서'...세금 81%는 '국내에,' [Samsung, 87% of profit is from abroad... pays 81% of tax in domestic], accessed February 28, 2019, <https://www.yna.co.kr/view/AKR20180615077600003>.

²⁷⁷ "South Korea's R&D Spending," *Business Insider*, n.d., accessed February 28, 2019, <https://www.businessinsider.com/south-koreas-rd-spending-2014-6>.

²⁷⁸ Mark Zastrow, "Why South Korea Is the World's Biggest Investor in Research," *Nature News* 534 (7605): 20, 2016, <https://doi.org/10.1038/534020a>.

²⁷⁹ "hanguk gonggong R&D seonggwa bujin...jiljeok sujune munje" 한국 공공R&D 성과 부진...질적 수준에 문제, [Korea's public R&D performance is sluggish... problem on quality level] n.d., *MK News*, accessed March 1, 2019, <http://news.mk.co.kr/newsRead.php?year=2015&no=152851>.

²⁸⁰ "Hanguk R&D, yangjeok seongjangeun segye choego...jiljeok seongjangeun jejari" 한국 R&D, 양적 성장은 세계 최고... 질적 성장은 제자리," [Korea R&D, quantitative growth is the world's best...Qualitative growth is in the same place], *Sisajeoneol* 시사저널, October 21, 2015, <http://www.sisajournal.com/news/articleView.html?idxno=144151>.

alarming rate. These M&As have more than quadrupled from 24 cases (total value of \$3.6 billion) from 2003 to 2007, to 100 cases (total value of \$4.9 billion) from 2013 to 2017.²⁸¹

Recently, Chinese companies and government officials have come to South Korea to investigate semiconductor equipment manufacturers. Chinese semiconductor companies have attracted top-level engineers from Samsung Electronics and SK Hynix by offering them a five-year guarantee of three times their annual salary. However, due to the complexities of the semiconductor industry, it was difficult to identify all manufacturing processes by taking a few engineers. China has attempted to bring about 100 Korean engineers at once for this reason. Chinese companies that failed to secure technology to mass-produce semiconductors through "extracting manpower" have begun to turn their eyes to South Korean semiconductor materials and equipment manufacturers.

China's M&A of strategic South Korean manufacturers is a strategy aimed at taking the entire information ecosystem that South Korea has accumulated for a long time. Since China has gained momentum with its *Made in China 2025* policy, it has started aggressive M&As in order to secure advanced technology. The current situation is not beneficial to the U.S. either. To impede the growth of high value-added industries of China, the U.S. has banned exporting its semiconductor machinery parts and equipment control software to Chinese DRAM manufacturers.²⁸² Semiconductor machinery and equipment are the United States' second biggest export to South Korea. If Korean semiconductor equipment manufacturers are absorbed into China, China can have indirect access to purchase U.S. manufactured semiconductor machinery parts. Rather, easing Korean M&A regulations to make it easier for U.S. companies to acquire South Korean chipmakers will benefit both the U.S. and South Korea, and might slow down Chinese technological advances.

South Korea-China Trade Relations in Midst of the U.S.-China Trade War

The trade war between the U.S. and China does not only affect the two countries' economies, but also affects other economies indirectly. South Korea, which heavily depends on exports, is one of them. South Korean media outlets have different opinions on how the trade war will affect the Korean economy. Some say that there will not be a substantial effect on Korean companies in China because they have already begun to move operations away from China after the U.S. and Korea decided to

²⁸¹ "Hanguk bandoche saengtaegye' tongjjae saryeoneun jungguk... inryeok ieo jangbieopche 'sanyang,'" 한국 반도체 생태계' 통째 사려는 중국... 인력 이어 장비업체 '사냥,' [China wants to buy the entire 'Korean Semiconductor Ecosystem'... 'Hunting' Human resources and equipment company], 2018, *Hankyung*, July 23, 2018, <http://news.hankyung.com/article/2018072303441>.

²⁸² "Miguk, jungguk bandoche gieobe bupum deung suchulgeumji," 미국, 중국 반도체 기업에 부품 등 수출금지, [Export of semiconductor parts from the U.S. to the Chinese companies is prohibited] n.d., accessed March 1, 2019, <http://www.hankookilbo.com/News/Read/201810302110067505>.

formally deploy the THAAD missile defense system in 2017. On the other hand, if China's economy is damaged by U.S. tariffs, they would subsequently reduce imports from South Korea. This would result in the necessity for South Korea to revise its economic structure to be less dependent on exports to China. Yet, a drastic reduction of South Korean exports to China would be unlikely since 79% of the total are intermediary goods consumed domestically.²⁸³

As a result, the South Korean government has announced a new policy that encourages corporations to increase economic activities with India and Southeast Asian countries. Meanwhile, President Xi of China has tried to restore relations with South Korea through a summit meeting held in December 2017. However, trade relations remain weak as China still has not fully lifted economic sanctions against South Korea, placed when it deployed the THAAD missile system. According to a 2018 report from China Institutes of Contemporary International Relations, Koreans think the U.S. is more important than China as a trade partner despite the fact that they trade more with China. Also, Koreans answered only 1.1% would support China if there is a military conflict between China and the U.S., and only 5.4% think China is a country of fairness and righteousness, while 25.7% think the U.S. is.²⁸⁴ It is significant that controversy over the THAAD deployment issue and the trade war has set Koreans to seek different paths to growth, moving away from China. The need for South Korean companies to exit China has become more apparent as Samsung Electronics is moving their factories to Vietnam and India, and Hyundai and KT&G are increasing their investment in Vietnam and Indonesia.

Conflict in North Korea

North Korea is a serious threat to U.S. and world security, as they are now believed to have up to 60 nuclear weapons.²⁸⁵ The second ballistic missile they launched on September 15, 2017 flew over Japan, a key ally of the U.S. In 2018, North Korea claimed that their new ballistic missiles' range is extended to 1,3000km,²⁸⁶ and that the entire continental United States is within the target radius. The

²⁸³ "'Hanguk, jungguksuchul 79%ga jungganjae'...jung daemisuchul gamso 'bulttong' twina" 한국, 중국수출 79%가 중간재'...중 대미수출 감소 '불똥' 튀나," [79% of Korea's exports to China are intermediate], n.d., *Hangyeore* 한겨레, accessed March 01, 2019, http://www.hani.co.kr/arti/economy/economy_general/839118.html.

²⁸⁴ "Mi-jung chungdolttae jungjiji 1.1%ppun'...junggukdo nollasda, hangugui hyeomjung" 미·중 충돌때 중지지 1.1%뿐'...중국도 놀랐다, 한국의 협중 [Only '1.1%' would support China if the U.S. - China military conflict break up ... China is also surprised], *Joongangilbo* 중앙일보, accessed January 30, 2019, <https://news.naver.com/main/read.nhn?mode=LSD&mid=shm&sid1=104&oid=025&aid=0002877808>.

²⁸⁵ "Kim Jong Un Has at Least 20 Nuclear Weapons, South Korea Says," n.d., *NBC News*, accessed March 01, 2019, <https://www.nbcnews.com/news/north-korea/north-korea-believed-have-60-nuclear-weapons-south-korea-says-n915721>.

²⁸⁶ Justin Washington and Julian Borger, "North Korea Missile Launch: Regime Says New Rocket Can Hit Anywhere in US," *The Guardian*, November 29, 2017, sec. World news,

U.S. realizes that there is a need to take action against North Korea to end its nuclear weapons and long-range missile activities,²⁸⁷ before further escalation. On November 2018, U.S. Vice President Mike Pence and Japanese Prime Minister Shinzo Abe reaffirmed the need to keep sanctions on North Korea to achieve denuclearization.²⁸⁸ Current sanctions the U.S. has imposed on North Korea restrict economic activities and target a larger list of individuals and businesses.²⁸⁹ The U.S. is preventing any individuals, businesses, and organizations from trading with North Korea by freezing assets and rejecting financial services as well as forcing foreign financial institutions to choose between doing business with the United States or facilitating trade North Korea.²⁹⁰

Meanwhile, the South Korean government is implementing friendly policies towards North Korea. After North Korea's ballistic missile flew over Japan, a plan to send \$8 million worth of humanitarian aid to North Korea was approved. During the third inter-Korean summit in April 2018, South Korea has suggested many projects such as connecting coast railroads and highways and establishing a special economic zone, creating "concerns in Washington that Korea is leaning over too far towards the North Koreans."²⁹¹ However, projects involving building non-profit infrastructure have to be approved by the UN Committee to be started. Projects that have a commercial purpose are restricted by the U.S. sanctions that forbid U.S. business partners from doing financial transactions with North Korea. For this matter, President Trump said, "South Korea will not lift sanctions on Pyongyang without U.S. approval."²⁹²

While the U.S. and South Korea remain allies and economic partners, it is essential for them to support the denuclearization effort undertaken by the United States. U.S. policy can not be successful if

<https://www.theguardian.com/world/2017/nov/28/north-korea-has-fired-ballistic-missile-say-reports-in-south-korea>.

²⁸⁷ "Review of United States Policy Toward North Korea: Findings and Recommendations," n.d., Belfer Center for Science and International Affairs, accessed March 01, 2019, <https://www.belfercenter.org/publication/review-united-states-policy-toward-north-korea-findings-and-recommendations>.

²⁸⁸ "Pence, Abe Agree on Nkorea Sanction, Indo-Pacific Projects," *Fox News*, n.d., accessed March 01, 2019, <https://www.foxnews.com/world/pence-abe-agree-on-nkorea-sanction-indo-pacific-projects>.

²⁸⁹ "What to Know About Sanctions on North Korea," Council on Foreign Relations, n.d., accessed March 01, 2019, <https://www.cfr.org/background/what-know-about-sanctions-north-korea>.

²⁹⁰ "President Donald J. Trump Increases Pressure to Cut off Funding for North Korea," n.d., The White House, accessed March 1, 2019, <https://www.whitehouse.gov/briefings-statements/fact-sheet-president-donald-j-trump-increases-pressure-cut-off-funding-north-korea/>.

²⁹¹ "Mi jeonmungadeul 'jaemubu hanguk eunhaeng jeopchok, 'sekeondeori boikos' gyeonggo" 미 전문가들 '재무부 한국 은행 접촉, "세컨더리 보이콧" 경고, [U.S. Professionals, Ministry of Finance 'contacts Korea Bank, for 'Secondary Boycott' Warning], *VOA*, n.d., accessed March 1, 2019, <https://www.voakorea.com/a/4611541.html>.

²⁹² "REFILE-Trump Says S.Korea Will Not Lift N.Korea Sanctions Without...," *Reuters*, October 11, 2018, <https://www.reuters.com/article/usa-northkorea-southkorea-sanctions-idUSL4N1WQ5YB>.

it does not align with the policies of allies in the region. Since the denuclearization of North Korea is the maximum U.S. interest in the Korean peninsula, trade negotiations may be actively used to help achieve it. If South Korea agrees to this, the U.S. can relax economic requirements, such as quotas, to draw their complete cooperation in prioritizing the denuclearization of North Korea. Jointly eliminating the nuclear threat of North Korea with South Korea will lead to greater levels of trade and cooperation with the U.S., as South Korea will be recognized as a legitimate driver of the denuclearization process.

Conclusion

U.S. relations with South Korea seemed shaky as the South Korean government refused to strengthen the U.S.-driven defense system against China and North Korea, and with the Trump administration's increased trade restrictions on Korean imports. However, South Korean companies are leaving China, and the U.S. has begun negotiations on denuclearization with North Korea. Now the U.S. needs to eliminate tariffs that are not conducive to the U.S. economy and establish stronger economic relations with South Korea to increase benefits, including creating more jobs and future economic cooperation in the North Korea region.

The South Korean government is seeking new places for companies to do business to improve their economy. Now is a good time to attract Korean companies to increase interdependence with the U.S., as well as with Japan. Even Koreans' favorable attitude toward President Trump has highly increased. According to surveys by Pew Research Center, Trump's credibility among Koreans has increased from 17% to 44% compared to the last year.²⁹³ Experts analyzed that the reason is his diplomatic progress with North Korea, including the denuclearization talks. North Korea wants to leverage their nuclear and missile program for economic and security benefits; the U.S. must work with allies to not let North Korea gain such benefits without eliminating a nuclear threat.

Policy Recommendations

- Eliminate safeguard tariffs which are ineffective for both U.S. manufacturers and attracting more Korean companies to the U.S.
- The U.S. should not impose tariffs on automobiles and auto parts. Further action may result in negative trade relations with South Korea. Tariffs may raise demand for the cars manufactured

²⁹³ "Hangugin 44% 'teureompeu sinroe'...jeonnyeonboda 17%eseo geupdeung "한국인 44% '트럼프 신뢰'...전년보다 17%에서 급등," [44% of Koreans believe in Trump... It soared from 17 percent last year.], n.d., *MSN News*, accessed March 1, 2019, www.msn.com/ko-kr/news/world/한국인-44percent-트럼프-신뢰...전년보다-17percent에서-급등/ar-BBNONYL.

in the U.S. but would increase the production cost, eventually making them less competitive in the global market.

- Continue discussions of increasing FDI and relocation of companies in order to create U.S. jobs.
- Pressure South Korea to open up its markets further, as promised in the KORUS FTA.
- Adjust measures to draw complete cooperation of South Korea in prioritizing the denuclearization of North Korea.

CONCLUSION

This Task Force has provided realistic policy options for the USTR on the subject of trade with Asia-Pacific nations. Through the analysis and research of available data and current events, this report stresses the importance of maintaining positive alliances in the region to foster stability under the guidance and accountability of international institutions, such as the WTO. The United States must understand new rising leaders on the world stage and adapt historical policy responses accordingly.

President Donald Trump's recent concern with U.S. trade, although misguided, has raised important questions about the future of U.S. trade policy. Currently, the Trump administration has implemented 10% tariffs on \$200 billion worth of Chinese goods and 25% on Japanese steel and 10% aluminum in response to concerns over the U.S. trade deficit and has threatened to further increase tariffs to 25%. However, the original March 1st deadline for the increase has been postponed indefinitely after a statement by President Trump. While we have found that tariffs have been beneficial in the short-term to get countries to negotiate, they are not effective in the long-run.

We find that China is at the core of the trade conflict in the Asia-Pacific. China's regional and global rise challenges the U.S.-led world order that has existed since the end of World War Two. Therefore, this trade war is more complex than simple trade policy, as our report shows. The deeper problem is a military rivalry which the U.S. fears could lead to a collapse of the world order and a sharp rise in influence of a nation with a very different set of values. This rivalry is shown in specific areas such as cybersecurity and high-tech manufacturing, both of which have military implications.

While China is a complicated case, trade policy in general is a useful tool not only to secure current alliances but to extend ideals of reciprocity and free-trade. It also promotes a world order that focuses on stability and win-win economic relations. Japan and South Korea are important allies to the U.S. now more than ever. Growing uncertainties surrounding China and conflicts with North Korea should urge the U.S. to strengthen these relationships. Any benefits to tariffs are far outweighed by the diplomatic consequences of breaking trust with key allies in the region. Instead, we should encourage trade and investment with Japan and South Korea, strengthen current agreements, and create new policies to formalize mutually-beneficial trade.

POLICY RECOMMENDATIONS

Diplomacy

There is an urgency to address changes in current diplomatic practices to repair the hard power projection of American exceptionalism through appropriate tone and dialogue. In order to secure successful trade negotiations and stability, we must encourage the executive branch and particularly the President to use constructive and cooperative language in all negotiations with China, Japan and South Korea, avoiding isolation and leading towards joint partnerships. It is vital to avoid an escalation of this trade war with China at all costs. Therefore, we must comply with region-specific context and cultural sensitivity, and negotiate in an inward and private manner, as opposed to sending out tweets regarding trade negotiations and other conflicts. Seoul is bordering North Korea and cannot risk a tweet which threatens civilian security from a nuclear threat.

Tariffs

This report maintains that the tariffs implemented by the U.S. have created strained relationships between the U.S. and China, and even with its allies Japan and South Korea. Moving forward, the U.S. should maintain its goal of economic prosperity and make tariff reduction a clear goal. It should remove tariffs that are impacting Japanese steel and aluminum sectors, since lowering tariffs on Japanese steel would make Japanese companies investing in U.S. production more feasible and would further stimulate domestic investment. The U.S. should pledge against placing tariffs on Korean automobiles, as implementing a tariff on automobiles would ultimately raise the price of car parts, thereby affecting the price of American cars, as well as harm our relations with South Korea. We also recommend that the U.S. should remove the Safeguard tariff on Korean appliances, as it is unnecessarily hurtful. However, this report acknowledges that in the case of China, the use of tariffs has been a potentially useful tool in obliging the Chinese government to consider changing some of its predatory trade practices, such as forced technology transfers. In light of this, the U.S. should not remove tariffs on Chinese goods in the short-term until the government has agreed to these changes.

Investment

This report provides recommendations for two types of investment policy: first, to promote investment between the U.S. and countries in the Asia-Pacific, and secondly, to modify current investment practices that are harmful to U.S. interests.

Increasing investment between the U.S. and allies such as Japan and South Korea would result not only in economic growth but would strengthen ties between all involved. This report believes increased economic interdependence through further investment will create regional stability despite China's rise. One way to do this is through encouraging inbound FDI from Japan and South Korea, specifically in the automobile industry, creating more U.S. jobs and strengthening diplomatic ties. With South Korea, it is in the interest of the U.S. to negotiate M&A FDI to foster U.S. investment in the South Korean semiconductor industry. This might also aid in slowing Chinese technological advances through the acquisition of South Korean companies. It is also important for the U.S. to encourage China to open its markets through deregulation to allow for increased U.S. investment.

We also recommend policy options to decrease certain investment policies that are harmful to national interests. It is necessary to control and prevent technology transfers that occur through joint ventures as well as through inbound investment from China. This can be achieved by encouraging the Committee on Foreign Investment in the United States to intensify regulations of Chinese investment, especially in high-tech sectors. In addition, enforcing stricter supply-chain accountability and regulations for U.S. firms looking to invest in China would decrease the potential for forced technology transfers.

Cybersecurity and Intellectual Property

China's rise poses the biggest threat to the U.S. in areas of cybersecurity and intellectual property, with implications ranging from U.S. economic harm to Chinese military advances. To counter Chinese behavior on cybersecurity, the U.S. should implement expanded measures regulating foreign investment, leverage current diplomatic alliances through the WTO, and increase funding for cybersecurity enforcement and investigation practices. Specifically, this would involve enforcing stricter supply-chain accountability for U.S. firms with operations in China and enabling the USTR or the U.S. Treasury Department to deny the use of U.S. banking systems to any foreign companies that have committed or benefitted from the theft of American intellectual property. Additionally, domestic measures shall be taken to increase funding and support for improved cyber-protection software, conscious internet safety, and improvements in the CFIUS department. The response to the severe cybersecurity issue cannot be undermined; therefore, if China does not meet these expectations, the U.S. must consider further punitive actions including but not limited to: blocking or limiting Chinese investment in the U.S. and imposing sectoral investment restraints.

Trilateral Agreement: Japan-U.S.-Korea

Currently, the U.S. and Korea are involved in a bilateral trade agreement, which supports free trade. In order to most advantageously develop in the region, the U.S. should continue to support free trade, by entering into a trilateral agreement between Japan, Korea, and the United States. Such an agreement would strongly support increasing trade and investment by eliminating trade barriers, growing industries in all member states, and increasing FDI. The sectors that should most strongly be focused on are the agricultural, energy, and automotive sectors. Doing so would not only ensure that Japan and South Korea are fairly treating U.S. goods in their markets, but also keep communications open. With the renegotiation of both the TPP and the NAFTA trade agreements, President Trump has already established a legacy of having the willingness to create new agreements in the face of existing ones. Such a trade agreement would be beneficial to U.S. interests on a geopolitical level as well. If the U.S., Japan, and South Korea came together in an economic coalition, China would have less power in the region relatively speaking. China's influence over not just North Korea, but South Korea's markets as well are concerning. The unification of a region resolved more heavily against China would prevent China's rise and further market influence. At the same time, because of the proximity of North Korea to South Korea, there is a great opportunity for South Korea to more firmly protect the region's stability. If South Korea is willing to assist in ensuring the stability of North Korea, the U.S. would be willing to relax their tariff policy and further facilitate investment in order to reflect that effort.

International Institutions

International institutions established under a U.S.-led world order after WWII are important to utilize in sensitive trade conflicts, specifically in the case of China. With China being a member of the WTO and benefitting from a unified promotion of reducing trade barriers, the U.S. should use this forum to challenge certain aspects of Chinese policy. Primarily, hold China accountable to general WTO membership guidelines such as free trade and reciprocity. This would involve opening the Chinese markets to foreign investment without forced technology transfers. Citing the WTO Agreement on Subsidies and Countervailing Measures specifically to challenge Chinese government subsidies is important to ensure a more equal international market for trade. The U.S. should also encourage the WTO to take punitive action against China regarding IP laws through the TRIPS agreement which prohibits forced technology transfer.

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