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# Trade wars & currency conflict: China, Japan, and South Korea's responses to U.S. protectionism, 1971-2013

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BOSTON UNIVERSITY  
GRADUATE SCHOOL OF ARTS AND SCIENCES

Dissertation

**TRADE WARS & CURRENCY CONFLICT:  
CHINA, JAPAN, AND SOUTH KOREA'S RESPONSES  
TO U.S. PROTECTIONISM, 1971–2013**

by

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## EPIGRAPH

*Trade War: noun. a situation in which countries try to damage each other's trade, typically by the imposition of tariffs or quota restrictions.*

*Currency Conflict: noun. also known as competitive devaluation, is a condition in international affairs where countries compete against each other to achieve a relatively low exchange rate for their own currency. As the price to buy a country's currency falls so too does the price of exports.*

## DEDICATION

I would like to dedicate this work to my beloved parents,  
Hyung-chai Park and Kang-hyun Choi.

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**ABSTRACT**

What political and economic factors have led Northeast Asian nations to react to U.S.-initiated trade and currency disputes differently? This dissertation analyzes the causes of the similarities and the divergence among the three countries in their trade and currency conflicts with the United States from 1971 to 2013. It argues that the divergence in the three countries' policy reactions to U.S. protectionist pressures can be best explained by differences in the political systems and bureaucratic decision-making structures of foreign economic policy and monetary policy. My research design is a *small-n* comparative research project, utilizing process tracing as well as regression analysis. It is based on two years of on-site fieldwork on the government decision-making systems of China, Japan, and South Korea. The dissertation develops in-depth case studies of each country's bilateral trade conflicts with the United States, as identified by disputes involving the United States International Trade Commission, the United States Department of Commerce, the United States Trade Representative, and the World Trade

Organization, as well as bilateral negotiations on currency appreciation carried out at the ministerial level. It also demonstrates causal linkages between trade and currency disputes, two related issues that are not addressed together in most of the international political economy literature.

## TABLE OF CONTENTS

EPIGRAPH.....	iv
DEDICATION.....	v
ACKNOWLEDGMENTS .....	vi
ABSTRACT.....	viii
TABLE OF CONTENTS.....	x
LIST OF TABLES.....	xi
LIST OF FIGURES .....	xiv
LIST OF ABBREVIATIONS.....	xvi
CHAPTER ONE.....	1
CHAPTER TWO .....	50
CHAPTER THREE .....	126
CHAPTER FOUR.....	178
CHAPTER FIVE .....	243
CHAPTER SIX.....	297
BIBLIOGRAPHY.....	309
CURRICULUM VITAE.....	327

## LIST OF TABLES

Table 1-1. The Argument in Brief: Key Variables in U.S.-Northeast Asian Trade Wars and Currency Conflicts .....	45
Table 2-1. Political System Structures in Japan, South Korea, and China.....	84
Table 2-2. Japan’s Postwar Political and Bureaucratic Transitions.....	88
Table 2-3. South Korea’s Postwar Political and Bureaucratic Transitions.....	101
Table 2-4. China’s Postwar Political Transitions and Financial Reforms.....	113
Table 2-5. Monetary Policy Committee members (1997.7 - 2003.3).....	118
Table 2-6. Monetary Policy Committee (2003.4 - current).....	118
Table 3-1. U.S. Antidumping and Countervailing Duty Investigations (Year-To-Date: Last Updated March 15, 2013).....	146
Table 3-2. Harmonized System Section Headings and Descriptions.....	147
Table 3-3. Antidumping Sectoral Distribution of Measures: By Reporting Member of the WTO (January 1, 1995 - December 31, 2012).....	148
Table 3-4. Countervailing Sectoral Distribution of Measures: By Reporting Member of the WTO (January 1, 1995 - December 31, 2012).....	148
Table 3-5. Japanese Legal Structure for Trade Remedies.....	158
Table 3-6. Japanese Decision Making Process of AD/CVD Cases.....	162
Table 3-7. South Korean Legal Structure for Trade Remedies.....	164
Table 3-8. Chinese Legal Structure for Trade Remedies.....	172
Table 3-9. Current Antidumping and Countervailing Duty Orders in place (as of September 23, 2013).....	175
Table 4-1. WTO Dispute Settlement Cases (as of August 12, 2014).....	193

Table 4-2. Distribution of the Dependent Variable.....	201
Table 4-3. Proportion of the Dependent Variable.....	201
Table 4-4. Estimated Coefficients of Logit Analysis for U.S. Dispute Initiation in the WTO (1995-2013).....	206
Table 4-5. Estimated Coefficients of Negative Binomial Regression Models for U.S. Dispute Initiation in the WTO (1995-2013).....	207
Table 4-6. U.S.-Japan Cases in the WTO DSB (1995-2013).....	214
Table 4-7. U.S.-South Korea Cases in the WTO DSB (1995-2013).....	224
Table 4-8. U.S.-China Cases in the WTO DSB (1995-2013).....	236
Table 5-1. Major U.S.-Northeast Asia Currency Conflicts and Country Responses.....	250
Table 5-2. JPY Appreciation against the USD (1949-1995).....	265
Table 5-3. Monthly Exchange Rates – October 1986 (Currency Units per USD).....	275
Table 5-4. U.S. Requests for KRW Appreciation, 1987-1989.....	275
Table 5-5. KRW Appreciation against the USD (1986-1991) (Unit: KRW/USD, %).....	276
Table 5-6. Asian Currency Appreciation against the USD after the Plaza Accord.....	276
Table 5-7. Developments in the U.S.-China Currency Dispute Timeline, 1994-2013.....	286

## LIST OF FIGURES

Figure 1-1. The Five Stages of U.S.-Northeast Asian Trade Wars and Currency Conflicts .....	45
Figure 2-1. Analytical Framework of Trade Wars and Currency Conflict: The Formation of U.S. Policy on the Three Countries.....	62
Figure 2-1. Analytical Framework of Trade Wars and Currency Conflict: The Formation of Japan, South Korea, and China’s Policy Responses to the U.S.....	62
Figure 2-3. Japan’s Macroeconomic Formation Structure.....	87
Figure 2-4. Japan’s Trade and Foreign Economic Policy Formation Structure.....	87
Figure 2-5. South Korea’s Macroeconomic Policy Formation Structure.....	100
Figure 2-6. South Korea’s Trade Policy Formation Structure.....	100
Figure 2-7. China’s Trade & Macroeconomic Policy Formation Structure.....	119
Figure 2-8. China’s Financial Regulatory System.....	123
Figure 3-1. United States Antidumping Investigation Procedures by the USDOC and the USITC.....	139
Figure 3-2. United States Countervailing Duty Investigation Procedures by the USDOC and the USITC.....	140
Figure 3-3. United States Safeguard Investigation Procedures by the USDOC and the USITC.....	142
Figure 3-4. Japanese Trade Remedy Procedures & Time Frames Flowcharts.....	161
Figure 3-5. South Korean Trade Remedy Procedures & Time Frames Flowcharts.....	168
Figure 3-6. China’s Investigating Authorities and Trade Remedy Process.....	172
Figure 4-1. The Main Stages of the WTO Dispute Settlement Body and Adjudication.	183
Figure 4-2. U.S. Trade Deficits against the World.....	188
Figure 4-3. U.S. Participation in the WTO (1995-2014).....	194

Figure 4-4. U.S.-Japan Trade Imbalances (1985-2013).....	209
Figure 4-5. Japan’s Participation in the WTO (1995-2014).....	214
Figure 4-6. U.S.-South Korea Trade Imbalances (1985-2013).....	223
Figure 4-7. South Korea’s Participation in the WTO (1995-2014).....	224
Figure 4-8. U.S.-China Trade Imbalances (1985-2013).....	232
Figure 4-9. China’s Participation in the WTO (1995-2014).....	236
Figure 5-1. JPY-USD Exchange Rates (1960-2013).....	265
Figure 5-2. KRW-USD Exchange Rates (1960-2013).....	280
Figure 5-3. RMB-USD Exchange Rates (1960-2013).....	293

## LIST OF ABBREVIATIONS

AD: Antidumping

AFC: Asian Financial Crisis

BOJ: Bank of Japan

BOK: Bank of Korea

CCP: Chinese Communist Party

CVD: Countervailing Duty

DPJ: Democratic Party of Japan

DSB: Dispute Settlement Body (of the World Trade Organization)

EPA: Economic Partnership Agreement

FDI: Foreign Direct Investment

FTA: Free Trade Agreement

GATT: General Agreement on Tariffs and Trade

GDP: Gross Domestic Product

GFC: Global Financial Crisis

JPY: Japanese Yen

KRW: Korean Won

KTC: Korea Trade Commission

IMF: International Monetary Fund

IPE: International Political Economy

LDP: Liberal Democratic Party, Japan

LTFV: Less Than Fair Value

MAFF: Ministry of Agriculture, Forestry and Fisheries, Japan

METI: Ministry of Economy, Trade, and Industry, Japan (formerly MITI)

MFN: Most Favored Nation

MOF: Ministry of Finance, Japan

MOFA: Ministry of Foreign Affairs, Japan

MOFCOM: Ministry of Commerce, China

MOSF: Ministry of Strategy and Finance, South Korea

MOTIE: Ministry of Trade, Industry and Economy, South Korea

NDRC: National Development and Reform Commission, China

NIC: Newly Industrialized Countries

OECD: Organization for Economic Cooperation and Development

PBC: People's Bank of China

PNTR: Permanent Normal Trade Relations

PRC: People's Republic of China

PSC: Politburo Standing Committee

RMB: Chinese Renminbi

S&ED: Strategic and Economic Dialogue between the U.S. and China

SOE: State-owned Enterprise

USDOC: United States Department of Commerce

USITC: United States International Trade Commission

USTR: United States Trade Representative

TPP: Trans-Pacific Partnership

TTIP: Transatlantic Trade and Investment Partnership

TVE: Township and Village Enterprise

VER: Voluntary Export Restriction

WTO: World Trade Organization

## CHAPTER ONE

### Introduction: Defining Trade Wars and Currency Conflict, 1971-2013

“I have directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold or other reserve assets, except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States.”

- Former U.S. President Richard Nixon, August 15, 1971 -

“The impact of the financial structure on trade has for too long been obscured or overlooked as a result of specialization by economists in either trade or money. The realization has been slow to dawn that the two must be taken together.”

- Susan Strange, ‘States and Markets’, 1988 -

"One of the challenges that we've got to address internationally is currency rates and how they match up to make sure that our goods are not artificially inflated in price and their goods are artificially deflated in price. That puts us at a huge competitive disadvantage."

- U.S. President Barack Obama, February 2010 -

## **Introduction: Institutional Structure and Policy Responses**

Over the past decade and a half, China has become a major economic rival to the U.S. and a primary target for U.S. protectionist measures. China's economic opening attracted foreign investment, a large portion of which derived from the United States, and its rise as a manufacturing house of the world has also led to contention with many trading partners, but for the most part, with the United States. Just a few years after China's economic opening, China found itself responding to multiple U.S. protectionist measures and requests for currency appreciation. Regarding the pressures, Chinese policymakers and scholars have come to question: "Why (only) us?"

In answering this question, the Chinese have felt unfairly targeted by the United States. However, what the Chinese often fail to realize is that U.S. protectionist measures have not only been imposed on other countries in the past – mainly on export-oriented East Asian economies – but also that these measures have been quite repetitive since the postwar period. US protectionist measures were imposed against Japan in the 1970s and 1980s, on South Korea and Taiwan in the 1980s and 1990s, and now, on China from the 2000s and onwards. Every East Asian economy that has gone through the economic developmental phase and generated trade deficits on the U.S. side has faced U.S. protectionist measures. However, responses have varied. China has resisted U.S. pressures and has in some cases initiated actions against the U.S. Japan's response can be better understood as acquiescence. South Korea demonstrated a mixed strategy in response to the U.S. pressures. This raises the question, "How were they different, and why?" In order to understand the variance amongst the cases of U.S.-East Asian trade and

currency conflicts, it is essential that we focus on how each country has responded, and why. In this dissertation, I argue that institutional variance amongst East Asian countries – China, Japan, and South Korea – has caused the variance of policy responses to U.S. protectionism.

### **Research Question**

Why did East Asian countries differ in their responses to U.S. trade and currency conflicts? The core of the argument is in *institutional variance* – the structure and process of policymaking that is inherent in each country’s political system. Institutions are the bureaucracy and policy decision-making structures and processes. The institutions of each country were not built or established in a day – they are the outcomes of political transitions and economic development. In order to understand each country’s institutional preparation at home to make policy, we must turn to the historical background of the bilateral relationships that each country has had with the United States. Although East Asian countries may retain similar features based on their export-orientation, each country has had a unique political, economic, and developmental history of its own. These differences became the foundation of institutions that are very distinctive from one another.

Institutions present the three bilateral cases with very strong explanatory power in analyzing the varied responses in bilateral economic relations. A very close look at each country’s institutional structure and process makes the macroeconomic and foreign economic policy responses more comprehensible than via other explanations such as those based on geopolitical or socio-cultural factors. Due to the widespread emphasis on

security dynamics in assessing U.S.-East Asian relations, scholars, policymakers, and policy analysts have overlooked the role of institutions in these countries, or at least failed to recognize that foreign economic policy decisions are in large part decided by relevant ministries, and not merely overridden by security policy decisions at all times. Some may also question the variance in the degree of U.S. pressures imposed on the countries. While the degree of U.S. pressures is a nebulous factor to quantify, more importantly the degree of U.S. pressures is certainly not the ultimate factor that led to the varied policy responses to trade and currency conflicts. The availability of domestic institutional preparation to address trade and currency conflicts is what ultimately leads to these policy variations.

In reviewing the literature on U.S.-East Asian bilateral economic relations, I find that a comparative analysis of trade and currency conflicts is missing. In addition, a microscopic view and comparisons of China, Japan, and South Korea's foreign economic making process are missing. The South Korean case, which has been investigated in less depth than the other two cases, is actually a peculiar hybrid case, which places South Korea between the Chinese and Japanese cases with regard to responses. While current discourse focuses primarily on the ongoing U.S.-China trade and currency conflicts, without a comparison to the previous cases of Japan and South Korea we fail to provide a clear explanation for why China presents a much tougher case for the U.S. policymakers today.

### **A Note on Methodology**

The basic context of my analysis is the three atemporal, bilateral economic relations that the U.S. has had with Japan, South Korea, and China. My periodization ranges from 1971 – the year of the Nixon Shock – to 2013. In order to conduct a comparative analysis ranging across different time periods in history, I have chosen process-tracing as my main method of investigation. I have examined three sets of cases: 1) bilateral trade disputes of antidumping and countervailing duty investigations by the USITC and the USDOC; 2) bilateral trade disputes in the Dispute Settlement Body (DSB) of the World Trade Organization (WTO) from 1995 (the year of WTO establishment) to 2013; and 3) bilateral currency appreciation pressures by the U.S. Treasury. All three cases embody responses from the three East Asian states.

My analysis is based on my two years of fieldwork in the ministries of Japan, South Korea, and China from 2010 to 2012. I primarily rely on my personal interviews with government officials, practitioners, and scholars of each country's trade and financial bureaus. I also depend on secondary sources such as the memoirs of retired government officials, ministerial releases, official reports released by governments and economic institutes, as well as media news reports.

### **Summary of Findings**

In the U.S.-East Asian trade wars (Chapter 3 & 4), I find that Japan has acquiesced, South Korea has reciprocated, and China has retaliated to U.S. protectionist measures, owing to differences in institutions. In the U.S.-East Asian currency conflicts (Chapter 5), I find that Japan has acquiesced with strategic intent, South Korea has resisted without a

clear agenda, and China has demonstrated a combined policy choice between resistance and incremental appreciation of its currency with the intent to internationalize it.

In trade disputes, Japan's policy response is based on the institutional features of a parliamentary system and strong technocrats – primarily in the Ministry of Finance (MOF), the Ministry of Economy, Trade, and Industry (METI), and the Ministry of Foreign Affairs (MOFA) – in the fields of trade and finance that the central government has delegated power to. Its acquiescence is based on the strategic bargaining that the Japanese institutions take on for the sake of rationalizing its foreign economic policy. The Japanese institutions set priorities based on governmental resource scarcity and budgetary restraint, resulting in its preference of consultations and resolution over disputes.

South Korea presents a hybrid case on trade disputes based on the omnipotent Presidency of a five-year term cautious of public opinion, which is highly sensitive to trade issues. As a result, trade or currency conflict matters are a very high priority consideration for South Korean policymakers. The bureaucratic system embodies flexible and expedited policy coordination amongst the ministries – mainly the Ministry of Strategy and Finance, the Ministry of Trade, Industry, and Energy (MOTIE), and the Ministry of Foreign Affairs (MOFA) – often pushing the speed of procedure at the expense of strategic choice and focus. Public-private partnership on trade related matters has become increasingly stronger, in addition to the implementation of retaliatory measures has given more impetus to trade disputes.

China's policy response to trade disputes is a result of a top-down decision making system under authoritarian rule descending from the Politburo to the State Council to the

ministerial level. While intra-ministerial coordination is quite difficult, the Vice Premier for trade and finance related matters and the Ministry of Commerce (MOC) retain strong governmental support for dealing with trade disputes.

On currency conflicts, Japan chose to appreciate the yen in large increments in the Plaza Accord of 1985, mainly due to pressures by the U.S. and other European economies, but also with its own intent to strategically align its economy with its western rivals. Japan made the choice mainly behind closed doors driven primarily by the MOF. South Korea's MOF (now MOSF) resisted the U.S. pressures but without a clear agenda of policy direction, sometimes even making the decision to retreat from confrontations with the U.S. at individual levels at the MOF rather than at the institutional level. South Korea's lack of strategy resulted in the accidental depreciation of the won in the Asian Financial Crisis. On currency, China presents the hybrid case, in which the Chinese Leading Group for Financial and Economic Affairs and the People's Bank of China (PBOC) fights the pressures by appreciating its currency in small increments, but ultimately aiming at internationalizing the renminbi in the longer run, eager to go on with the task of capital account liberalization.

### **Trade Wars and Currency Conflict, 1971-2013**

For the past two centuries, trade and currency matters have gone hand in hand in the global economy. In the policy world, it has become increasingly difficult to disassociate trade politics with exchange rates and monetary policy. As the world economy has grown more interconnected, the nexus of trade and finance has become a crucial point to address in the field of political economy. In a highly globalized and liberalized world economy,

despite international agreements to promote freer trade, trade wars have occurred in the forms of tariff levies, non-tariff barriers, domestic trade remedies via anti-dumping and countervailing duty investigations, safeguards, government subsidization, and legal trade disputes in international platforms. Interest rates and exchange rate policies have also been delicately intertwined with trade dynamics and international capital movement. Since the 1970s, currency appreciation pressures were placed on many export-led economies, which kept their local currency value low for competitive advantage in exports. While these pressures ignited bilateral political confrontations, some of the pressures worked, and some did not. At the onset of the Global Financial Crisis of 2008-10, central banks of advanced economies launched quantitative easing and low interest rates, which increased their money supply and prompted a global capital 'carry trade' to emerging economies with higher interest rates. Reminiscent of the Asian Financial Crisis of 1997-98, financial ministers of emerging economies raised their voices in support of measures to limit short-term capital inflows for fear of near-term inflation or currency appreciation and of future capital flight – hot money. In the global economy in which trade and currency dynamics are intertwined, trade wars and currency conflicts have been endemic for decades, are ongoing as of this writing, and are likely to recur for years to come.

For the last decade, the geographic focus of trade and currency conflicts has shifted due to the rise of China - both in security and economic terms. China has made remarkable progress in economic development in the past decade based on soliciting FDI

and excelling in manufacturing. However despite its economic growth, China has always been surrounded by controversies regarding its trading patterns and low currency value.

China presents both the repeat of an old story and a new puzzle. For one born and raised at the height of industrialization in the 1980s and 90s in the heart of Seoul in South Korea – a country in which economic miracles were made in just decades after the Korean War (1950-53), following the course of the Japanese developmental model – China's story of development seemed quite familiar. In the beginning phase of China's takeoff in economic growth and success, when it surpassed Japan in terms of aggregate GDP, some regarded its case as extraordinary. Technically, there are a lot of differences in the Chinese developmental model as compared to the previous developmental models of Japan, South Korea or Taiwan. The Chinese model embodied more market access via solicitations for FDI into the Chinese mainland. But truth be told, China's focus on manufacturing, the maintaining of a low currency, and very strong capital controls were stories similar in key respects to the stories in the earlier developmental stages of Japan, South Korea, and Taiwan, as trade frictions and currency disputes have accompanied export-oriented growth. And at the bottom of it all, the opponent in the trade and currency conflicts was mainly the United States.

But while in its basic outline, U.S.-China frictions are just another iteration of the same old story, there are also key differences. Size is clearly one. While at first glance, it looks as though size is what really matters, a closer look suggests that size is not a significant factor in terms of policy choices. What mattered the most was *the response* - how the Chinese response to the trade and currency disputes differed significantly from

the responses in previous cases. Had U.S. coercion worked on China easily, perhaps much of the debates on the China threat would not be of much issue in the U.S. policy making world. In foreign affairs, it becomes problematic when you are not getting the responses that you wish or expect, and this was all the more the case for U.S.-China relations. That said, what seemed to be the more interesting puzzle was: *what political and economic factors have led Northeast Asian nations to react to U.S.-instigated trade and currency disputes differently?* In other words, how countries chose to respond – depending on their domestic institutions and decision-making structures was what made the differences in policy outcomes so clear. How did the Japanese government respond? What about the South Korean government? Why does the Chinese response present a tougher case than the previous two? As I unraveled this question, I found that the source of divergence in the reactions of the countries I was observing was what was really making this story special. This dissertation seeks to explain the similarities and the divergence of the three cases of Northeast Asian trade wars and currency conflicts against the United States.

### **Postwar Northeast Asian Bilateral Relations with the United States**

Spreading democracy and promoting free trade have been the main pillars of U.S. foreign policy from the early 20<sup>th</sup> century. The United States has played a crucial role in the industrialization of Northeast Asian countries. During the era of imperialism in the late 1800s, the U.S. compelled Japan to open up, leading to the transformation of Japan through the Meiji restoration in 1868. During the post-war period after WWII, the U.S. temporarily ruled, managed, and provided developmental aid to the devastated Japan

when it surrendered to the allied forces in 1945. The U.S. also provided aid to the poverty-stricken South Korea after the Korean War from 1950 to 1953. The underlying objective for U.S. engagement in these two countries in the post-war years was obvious: to halt the spread of communism. The main reason for U.S. involvement in and alliance with these two countries had been containing Soviet-led Marxism and Leninism in Asia.

Subsequently, in the interests of further market expansion and building economic ties, the U.S. encouraged the market opening of Japan. South Korea and Taiwan followed suit. But the reversal of trade dynamics in all three markets could not have been predicted by the U.S. Indeed, these countries were very much hard hit during the wartime. Never did the U.S. imagine that a shift would occur in the economic upheavals of the post-war recoveries. Japan outperformed U.S. expectations and heavily engaged in trade with the U.S. South Korea and Taiwan, albeit to a lesser extent in absolute scale compared to Japan, performed extremely well and created economic miracles labeled as the 'Asian Tigers' in parallel with Hong Kong and Singapore. When trade dynamics were reversed by these countries one by one, the U.S. found itself bound by the economic opportunities that it had created for its interests by engaging in trade with its Northeast Asian security allies.

The U.S. bilateral engagement with China also began with a national security interest in the early 1970s. China's border conflicts with the Soviet Union escalated in 1969. The camaraderie between the two primary communist powers was on shaky ground. China had also been placed in a very difficult economic situation after the subsequent failures of Mao's attempt at economic development in the Great Leap Forward and the Cultural

Revolution in the 1960s. It did not help that the Sino-Soviet competition in Vietnam after the French withdrawal from Indochina was growing more intense. The Soviet Union and North Vietnam relations were developing in terms of Soviet aid, trade relations, and communist bonding. China's motivation for involvement with the U.S. was based on security calculations of avoiding encirclement by the Soviet influence. In 1968, the U.S. announced it would stay neutral regarding a possible Sino-Soviet war, but expressed its concerns and displeasure at the prospect of a Soviet strike against China.<sup>1</sup> The U.S. was signaling that it would be ready to lend subtle help in the event of a Soviet attack on China. In the Sino-U.S. rapprochement, Pakistan and Romania acted as intermediaries. Sino-U.S. talks began at the secret level with Special Envoy Henry Kissinger in 1971, and eventually led to former U.S. President Richard Nixon's visit to China in 1972.

But China was already communist from day one when Mao's CCP won the civil war against the KMT which fled to Taiwan in 1949. This was in stark contrast to the characteristics of the U.S relationship with China from its relations with Japan, South Korea, and Taiwan, in which the U.S. successfully blocked the spread of communism. This meant that the U.S. and China could not always be on the same page in their relationship in the years to come – China's leadership stood on its own communist ideological roots despite its intent and eagerness to engage in international trade, and labeled their outcome of reform 'market socialism with Chinese characteristics'. This meant that the U.S. would not have the same kind of brotherhood with China that was built over the years with Japan and South Korea, who established strong alliances and

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<sup>1</sup> Garver, 1982. pp.77-79.

<sup>2</sup> Lindner, 1992.

<sup>3</sup> The U.S. Treasury approached both countries in order to request for an appreciation of their currencies. They were both listed in the exchange rate manipulators list from to.

partnerships with the provision of a nuclear umbrella against Soviet and North Korean threats.

### **Export-oriented Industrialization: Northeast Asia Takes Off**

#### *Japan*

During the initial phases of economic buildup in Japan and South Korea, both received aid from the United States and the international society for postwar reconstruction and economic development. Japan took off and led the industrialization process in the postwar period in the 1950s and 60s. During the SCAP (Supreme Commander for the Allied Powers, 1945-1951) period, Japan was under American rule and management, and Japan's international trade was controlled by the United States. By the time the Americans had left and the MITI had embarked on its economic development strategies in 1954, its economy had overcome the s post war setbacks via its role as an export platform and a military procurement base for the United States during the Korean War. This quickly propelled Japan's industrialization processes. MITI's success in making the Japanese miracle possible labeled Japan and its governmental structures 'Japan, Inc.'. In the private sector, Japan's *keiretsu* (系列) developed horizontal and vertical integration, which would lock out foreign competition in the Japanese market. The government relaxation of anti-competition laws made possible the birth of conglomerates called *zaibatsu* (財閥), which heavily dominated the domestic markets with a focus on certain quality products. The Development Bank of Japan prioritized and strategically invested in the main pillars of the economy: shipbuilding,

automobile, coal, and steel production. During the Golden Sixties, under former Prime Minister Ikeda, Japan successfully achieved its goals in the Income Doubling Plan.

But during the initial phase of Japan's opening to the world economy, though it was committed to international trade, the largest portion of Japan's foreign trade was with the United States. In other words, Japan was heavily reliant on the U.S. market. Other factors such as non-tariff barriers, heavy capital controls (until the Big Bang in the 1980s), low value of the Japanese yen, and government subsidization for protection of home industries came under American scrutiny, and became the fundamental reasons for the U.S. to pursue uncompromising trade strategies against Japan in the subsequent decades as Japan's trade surplus with the United States soared. Japan proclaimed to the world that it successfully overcame postwar economic calamities with the 1964 Tokyo Olympics. During the GATT period, as the U.S. policy makers pushed for hardline tactics to limit Japan's exports into the United States, Japan found itself continuously cornered in anti-dumping, countervailing duty, and safeguard investigations. Japan chose to step back at times, with voluntary export restrictions and elimination of some non-tariff barriers during the strategic dialogues with the United States, in which a series of bilateral consultations were convened to lessen the impact of Japan's selling to the U.S. But these strategies were largely unsuccessful on the part of the U.S. Demand for high quality, low cost, Japanese products, had penetrated and become deeply rooted in the U.S. domestic market. Under the WTO system, Japan still faced these contentions in trade, but to a lesser extent than it did in the GATT system. In the WTO years, Japan grew legally capable and powerful enough to file and respond to trade disputes. Defending the

proactive sectors of manufacturing was vital to Japan's interests. Domestic preferences remain in Japanese manufacturing, but have been threatened over the years, especially since with time Japan has had to offshore its manufacturing bases to developing nations with lower labor cost to keep prices down. From the late 1980s, after its bubble economy burst, Japan has had to build a reinforcing mechanism for its trade by diversifying its trading partners, constructing regional production networks particularly in Southeast Asia, and facilitating the creation of various trading routes for its proactive sectors. Meanwhile, due to domestic political interests, its defensive sector of agriculture and fisheries remained highly secluded and protected from foreign competition. Maintaining a balance between the proactive and defensive sectors has been the main characteristic of Japan's trade policymaking, but now its agricultural sector is becoming increasingly marginalized. All throughout the export-led industrialization, Japan's political stability under the '1955 System' dominated by the Liberal Democratic Party also contributed to Japan's ability to focus on economic development and industrialization.

### *South Korea*

South Korea's economic development did not take off until under the leadership of Park Chung-hee, when he created an economic developmental model based on that of Japan. In fact, in the 1960s, during the Kim Il-sung regime, South Korea's economy performed far less impressively than its adversary across the 38<sup>th</sup> parallel border, North Korea. Educated and trained in Japan, Park planted the Japanese economic model into the Korean economy, and invested heavily in strategic sectors of heavy industries and engineering just as the Japanese had. Park initiated import substitution industrialization

from the 1960s, launched the Heavy-Chemical Industry (HCI) drive in order to build a modern military to that could stand against North Korea in the 1970s, and ultimately shifted gears toward export-oriented industrialization. In the 1980s and 90s, South Korea and Taiwan targeted the U.S. market, and although their actions at the time were not perceived as a critical threat to the U.S. economy by policy makers (as compared to the Japanese case), their low-cost goods heavily relied on the U.S. market. In the end, South Korea managed to launch its steel industry with loans and technical assistance from the Japanese government, and the development of the steel industry became the impetus needed for the production of automobiles and shipbuilding. As the import surge from South Korea continued from the late 1980s, the U.S. consistently pressured South Korea to gain further market access for American products into South Korea, and also for appreciation of the South Korean won. South Korea responded mildly to U.S. pressures, and while it succeeded in temporarily deflecting U.S. pressures at times, such responses were not necessarily based on strategic planning. South Korea sought to grow further by continuing to export and keep its currency value low. Its strong presidency and incumbent party across different administrations heavily influenced the direction of the economy, and thereby also impacting government-business relations tremendously.

But the strong government-business bonding and relationships would cause several problems in the system – corruption and market distortion for the most part – that went unnoticed internationally until the Asian Financial Crisis spread to South Korea from Thailand, Indonesia, and Malaysia. Hot money flooded out of South Korea. Under President Kim Young-sam, South Korea faced international criticism for corruption,

moral hazard, and most of all, lack of strategic economic planning after the developmental phase. The economy was revived with an IMF rescue package under the Kim Dae-jung regime. Korea's IMF loans were paid off by restructuring the public and private sectors, stimulating the economy by implementing lax government policies on credit creation, and citizenry efforts in sacrificing their personal resources, such as gold, for the good of the country. The South Korean public was severely shaken by the restructuring and changes. The plunge and fast recovery of the economy took South Korea to another level of liberalization. Like Japan, South Korea did not give up on what it was good at: its manufacturing and export-led platform. It continued to export to the United States, and diversified its trading partners, signing and ratifying multiple trade deals in the forms of FTAs and EPAs beyond the WTO framework in the 2000s and onwards under the Roh Moo-hyun, Lee Myung-bak, and Park Geun-hye administrations.

### *China*

Meanwhile, China's intent for economic development began with Deng Xiaoping's launch of economic reforms in 1978. China has had great potential for foreign investors due to an abundance of cheap labor and vast potential markets. China developed a great deal during this period, and started trading with the world. At the time, China was exporting low-cost primary goods, mainly agricultural goods and raw minerals, to some trading partners including the U.S.

In the 1990s, the government's strategic push of certain industries via the rise of state owned enterprises (SOEs) in major cities pushed China to another level of industrialization. The SOEs in China now played the roles of *cai fa* (财阀), equivalent to

those by *zaibatsu* (財閥) in Japan, or the *chaebol* (재벌) in South Korea. China was now producing steel and metals, materials central to industrialization. After several attempts and struggles in negotiations, China fully entered the world economy when the CCP leadership successfully negotiated its way into the WTO in 2001. For the Chinese people, China's entrance into the world economy was a significant transitional event in their lives, and is referred to as *ru shi* (入世), literally meaning 'entering into the world', or the global economy. Foreign direct investment flocked into China, and factories were offshored to China to benefit from the cheap labor provided by migrant workers from the Chinese countryside. In 2008, China's economic success was demonstrated during the Beijing Olympic Games, amid concerns about the country's environmental degradation. Since 2010, China has been producing both lightweight manufactured goods, from textiles and furniture, to heavy industrial goods, such as cars and airplanes. China's growth during the 2000s was record-breaking, until the onset of the Global Financial Crisis began to slow down its economy. While its competitive advantage of cheap labor has slowly died out and factories have been offshored to other destinations like Vietnam, China still is the number one manufacturing house in the world today. But as much as it engages in global trade, China is heavily involved in a series of trade disputes with its trading partners, particularly with the U.S. The People's Bank of China's management of the renminbi value has been consistently questioned over the years, although incremental appreciation has come. China's development phases are encounters of further liberalization, in addition to what the Japanese have encountered in the 1980s and the

South Koreans have encountered in the 1990s. Whether China will continue to liberalize with stability in its economy remains a question today.

### **Playing Hardball: U.S. Protectionism and Coercion**

Following both world wars, the U.S. had its heyday as the successful manufacturing center of the world. When the U.S. started to lose market competitiveness due to the rise of Japanese goods in the 1960s and 70s, it had to find a way to cope with a new economic reality. So when high quality and cheaply priced Japanese goods started to overtake the U.S. market, the U.S. turned to selective trade protectionism. In contrast to the U.S.-China case, in which market access was less of a problem, U.S. firms were concerned about both limited access to Japanese markets and by surges of Japanese import products into the U.S. Still, some of the major U.S. trade policy tools involved denial of access to the U.S. market for Japanese firms. Regarding currency issues, exchange rate policy examinations were included in the Omnibus Foreign Trade and Competitiveness Act (OCTA) of 1988, and were also featured regularly in the U.S. Treasury Reports to the Congress. In 1988, under the OCTA, Taiwan and South Korea were labeled as currency manipulating countries. Ultimately, the U.S. Treasury had negotiations with South Korea on exchange rate 'manipulation'.<sup>2</sup>

For the United States, trade deficits were accumulating yearly from the early 1970s. Reducing trade imbalances had certainly been on the U.S. agenda, and the U.S. sought to do so via placing various political pressures on its trading partners, but in practice it was not easy for the U.S. to shrink its trade deficit. This is when currency appreciation

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<sup>2</sup> Lindner, 1992.

pressures came into play. Japan strategically acquiesced to U.S. currency appreciation pressures in the 1980s, particularly after severe trade conflicts in the 1970s and the Plaza Accord in 1985. Taiwan and South Korea also made efforts to make mediocre yet partial adjustments upon U.S. request in the late 1980s to appreciate their currencies.

Nonetheless, U.S. efforts to reduce its trade imbalances via exchange rate adjustments were to no avail.<sup>3</sup> Especially after China entered the WTO based on the U.S. Congress grant of the Permanent Normal Trade Relations (PNTR) status, U.S. trade imbalances mounted up in record-breaking figures. The accumulation of trade deficits could be attributed to the overwhelming consumerism in America – consumption in the U.S. continued and further propelled import surges from exporting partners of East Asia. But they could also be result of the structure of global finance – in which the U.S. dollar has plays a key role. The dollar has appreciated considerably since the beginning of the 1970s. Economists interpreted this trade balance shift as evidence that the dollar was overvalued.<sup>4</sup>

### **U.S. Trade Wars with Northeast Asia**

From the 1970s, the U.S. saw an upsurge of foreign competition for their industries. The main competitors were their German and East Asian trading partners. As industrial interests in the U.S. were increasingly challenged over time, the need to take action was reflected in the U.S. policy realm via industrial lobbying to the U.S. Congress.

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<sup>3</sup> The U.S. Treasury approached both countries in order to request for an appreciation of their currencies. They were both listed in the exchange rate manipulators list from to.

<sup>4</sup> Destler, 2005, p.43

Under the GATT system, the U.S. engaged in trade conflicts with Northeast Asian countries mainly via domestic decisions to file an investigation that would lead to a bilateral confrontation of matters in trade. The surge of investigations from the 1970s reflect the result of organizational changes – the transfer of the U.S. Trade Remedy Bureau from the Department of Treasury to the Department of Commerce, which solicited many industrial persons to petition cases to protect their interests.

During this period, bilateral trade conflicts based on its domestic decisions had been the norm for the U.S., because the GATT system did not embody a full-fledged dispute settlement system to judge on trade conflicts, and also because the U.S. enjoyed considerable unilateral power over trade matters. This tradition continued onto the U.S. leverage of power in the WTO system, when the Dispute Settlement Body (DSB) of the WTO was established after the completion of the Uruguay Rounds. The WTO DSB embodied the setup of an international trade court, and became an additional platform in which bilateral trade disputes could be brought to at the international level. The U.S. has been the most active complainant in the WTO after the EU and remains one of the most aggressive pursuers of WTO dispute initiations to this day.<sup>5</sup>

The Japanese challenges to U.S. industries in the 1960s and 70s were threatening to U.S. producers. The sources of Japanese competitiveness derived from various factors: the undervalued yen, government-industry relations, enterprise organization and management, and the social cohesion and lifetime employment conditions that bound all

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<sup>5</sup> Davis, 2012, p.9

workers to pay allegiance to their corporate cultures.<sup>6</sup> When the U.S. started to lose market shares for electronics and automobiles to Japanese products at home, and industrial profits started to decline considerably due to competition with Japan, U.S. policy makers saw that the threats from Japan needed to be addressed properly.

The U.S. continued to gradually lose competitive ground to Northeast Asian exporters as South Korean and Taiwanese goods started to flow in. Imports from China trickled in, but remained largely primary products during the 1980s and into the early 1990s. Chinese trade acts of dumping were captured by the U.S. government and were put to questions via anti-dumping and countervailing duty impositions as they would with the cases of Japan, South Korea, and Taiwan. The USITC records show that China was under scrutiny for anti-dumping investigations from the year 1980, although Chinese import products at the time were lightweight consumer goods that did not gather political interest sufficient to ignite a trade war.<sup>7</sup>

### **U.S. Currency Conflicts with Northeast Asia**

Prior to the Nixon Shock in 1971, former U.S. President John F. Kennedy considered devaluation of the dollar impractical, as it would undercut the dollar-based exchange rate system since 1944 under the Bretton Woods System.<sup>8</sup> However, following the Nixon Shock, as the trade imbalances mounted exponentially, it became all the more difficult for U.S. policy makers to avoid a currency conflict with its trading partners. The U.S. needed to find a way to stabilize the dollar. In December 1971, the Group of Ten –

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<sup>6</sup> Baranson, 1981.

<sup>7</sup> On one note,

<sup>8</sup> Destler, *ibid.*

Belgium, Canada, France, Italy, Japan, the Netherlands, Germany, Sweden, the U.K., and the U.S. – gathered at the Smithsonian Institution to sign the Smithsonian Agreement in which they decided to appreciate their currencies against the dollar. By this agreement, a new set of parities was placed that reflected revaluation against the dollar. The gold standard of the Bretton Woods system came to an end when the fixed rates were abandoned in 1973 and ratified in the IMF charter in 1976. Since then, the world economy has been functioning with the dollar as the main anchor.

Under the gold-dollar system, it was understood that the U.S. would keep on mounting record-level trade deficits.<sup>9</sup> Based on the dollar under the gold-dollar system, Robert Triffin argued in the 1960s that a country whose currency serves as an international reserve currency must be willing to supply the world with an ample supply of its currency to fulfill the demands, and this would thus lead to a trade deficit for the country. This is a counter argument to the concept of ‘exorbitant privilege’, coined by Valéry Giscard d’Estaing, former President of France, who contended that the U.S. has alleged benefit in international transactions that could avoid a balance of payments crisis due to its own currency – the dollar – being the international reserve currency.<sup>10</sup>

The gold-dollar system broke down as a result from the Bretton Woods system, and the world now functions on a multi-currency system, largely swayed by the dollar. Since the lapsing of the gold-dollar system, the dollar has played a major role in the multi-currency system. Because the dollar serves as an anchor, the fluctuation of the dollar is critical to economies whose value of national currencies are highly influenced by the

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<sup>9</sup> Triffin, 1960.

<sup>10</sup> Eichengreen, 2011.

dollar. Most of these national currencies are not key international currencies, and transactions with other currencies are made via exchange of currencies into dollars. The dollar still carries a lot of weight in credibility and is more easily transferable than any other currency in the world today. Although the dollar has weakened in the aftermath of the Global Financial Crisis, there is no other substitute that could replace it at the moment. The influential role of the dollar has been the force driving U.S. currency appreciation pressures. In the four decades since the Nixon Shock in 1971, time and again U.S. policy makers in the Department of Treasury, from different U.S. administrations – regardless of party politics, or trends in trade policy have approached foreign central bankers and finance ministers with the intent to pressure them into currency appreciation. Currency appreciation pressures under the multi-currency system with the dollar as an anchor have become a repetitive pattern of U.S. foreign economic policy.

### **Japanese Yen, South Korean Won, and Chinese Yuan**

Currency conflicts have arisen repeatedly over the decades since the Nixon Shock. Over much of that period, Japan was the main target of U.S. pressure. More recently, South Korea and China have been criticized for currency manipulation.

#### *Japanese Yen*

The U.S. pressures for currency appreciation were directed mainly at the Deutsche mark and the Japanese yen in the 1980s. As the pressures on the appreciation of both currencies were enforced, Japan saw it as a threat to its economy, and as a result industry and policymakers became divided on the costs and benefits of the appreciation of the yen. But some Japanese policymakers in the Ministry of Finance and Bank of Japan also saw

it as a strategic opportunity: appreciating the Japanese yen would enable their currency to play a bigger role in the global economy, in parallel with the other major players – the U.S., the U.K., France, and West Germany. By the time the Plaza Accord was signed on September 22, 1985, Japan was already a major economic player. The mainstream view is that Japan and West Germany, together with the rest of the G5 members, strived to achieve the stability of the U.S. dollar via cooperation and dialogue in the Plaza Accord. Japan strategically acquiesced to the currency appreciation pressures initially imposed on it by the United States after rounds of negotiations toward the Accord. However, appreciating the Japanese yen in large increments at once also brought about some unwelcome consequences. The appreciation of the Japanese yen would drive Japanese industries to seek offshoring in foreign countries, such as Southeast Asian countries, where they could create production networks at a lesser cost.

#### *South Korean Won*

The effect on South Korea's policy of the U.S. pressures on KRW appreciation was rather minimal in comparison to Japan. This may have been partially due to the relatively small impact on the U.S. economy that South Korea had in comparison to Japan or Germany at the time of the currency appreciation pressures. In the latter part of 1986, South Korea began consultations with the U.S. Treasury on the matter of currency, as it was identified as one of the currencies not following the currency adjustments made in the Plaza Accord.<sup>11</sup> In its consultations with the IMF, the South Korean government agreed to increase the rate of appreciation of the won and to relax foreign exchange

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<sup>11</sup> U.S. Under-Secretary of Treasury David Mulford, 1986.

controls in April 1987. In 1988, the U.S. Department of Treasury identified currency-manipulating countries targeting economies with external surpluses and a managed float with restrictive capital controls. South Korea and Taiwan were among the targets. Economies with external surpluses with floating exchange rate regimes (Japan, Germany, and Hong Kong) were not targeted at this stage.<sup>12</sup> The U.S. Treasury reasserted its findings in subsequent reports to the Congress in 1989. However, economists and certain policy makers did not find sufficient grounds for placing pressures on South Korea, as it was a developmental state.<sup>13</sup> As in the case of China in recent years, then U.S. Secretary of Treasury Baker did not support Congressional attempts to mandate resolutions to the questions of exchange rates regarding South Korea, but planned only to continue negotiating with South Korea. All in all, contrary to the testimonies given by the incumbent Ministry of Finance (now MOSF) stressing that South Korea resisted the pressures and carried on its practices strictly based on market mechanisms, in the 1980s South Korea did make some adjustments in response to U.S. pressures for appreciation of the Korean won.<sup>14</sup>

### *Chinese yuan (renminbi)*

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<sup>12</sup> The First U.S. Treasury Report to the Congress on International Economic and Exchange Rate Policy, October 24, 1988.

<sup>13</sup> Bergsten and McKinnon argued that the pressures should be placed on Japan and Europe, not developing states like South Korea.

<sup>14</sup> South Korean finance officials argue with fervor that South Korea did not succumb to U.S. currency appreciation pressures in the 1980s, and that appreciation of the South Korean won was purely based on market mechanisms. This may have been partially true in 1989 when the South Korean government had already gone through series of consultations with the IMF on its currency, but evidently when the controversy on the won's value arose in the U.S. congress in 1986, this was not the case. The assertions of the current MOSF officials on South Korean position at the time is partially correct in that in late 1989 South Korea's Finance Minister Lee reported that the South Korean government would not artificially depreciate or appreciate the won against the dollar, but instead introduced plans to liberalize South Korea's foreign exchange system and full convertibility of the won.

U.S. pressures on Chinese currency appreciation have been by far one of the most daunting tasks in the history of currency conflicts that the U.S. Treasury has engaged in. China's currency issues were borne in a different political atmosphere in which the Chinese and the Americans faced an increasing amount of distrust despite increasing volumes of trade and investment. The U.S. dollar has become considerably weak during the previous financial crisis. It was not a strategic choice for China to budge like Japan did in the 1985 Plaza Accord or to delay their response like the South Koreans did in the latter part of the 1980s. China understood this logic, and thus has been appreciating the renminbi, albeit in small increments. It appreciated the renminbi once in 1994, and has been appreciating the renminbi incrementally since 2001 when it joined the WTO. Because of the renminbi appreciation that is happening, it is becoming more difficult to argue that the renminbi is a currency at low value as opposed to the dollar. China also sees its stakes in internationalizing the renminbi, and the forecast of the internationalization is reason to believe that it will appreciate its currency further.

Meanwhile, China's surpluses from trading with the U.S. have been on slight decline, but continue to be a crucial part of the ongoing U.S. China Strategic & Economic Dialogue (S&ED) in addition to the talks on currency appreciation.<sup>15</sup> The S&ED saga will continue for the time being as the U.S.-China economic relationship ripens into the near future. As for the Chinese response to U.S. currency appreciation pressures, China has shown a hybrid response amongst the Japanese and Korean cases. China's political

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<sup>15</sup> Because the People's Bank of China has been appreciating the Chinese yuan over the years in the 2000s, albeit in incremental terms, some economists have come to shake heads on the idea that the Chinese would not budge at all against U.S. pressures.

regime and foreign economic decision-making structure enables China to say no to extreme demands by the United States. However, it also sees its future interests in internationalizing its currency, and in order to do so, appreciation of the currency is a step that it must take.

### **Market Liberalization and Management of Financial Crises**

In macroeconomics, the open economy policy trilemma states that any country can choose only two of the following three desirable options: (1) monetary policy autonomy to target domestic activity; (2) free capital flows; and (3) exchange rate stability. At the beginning of their industrialization processes, Japan, South Korea, and China sacrificed the second component by exercising strong capital controls to acquire monetary policy autonomy and exchange rate stability. Eventually, they in turn went through the common cycles of market liberalization and financial crisis management, but in different patterns.

#### *Japan*

Japan's liberalization of capital occurred from 1974 – following the oil crisis and the launch of the Japanese welfare system in 1973 – to 1989 when the Japanese bubble economy burst. With the expansion of the national welfare program in Japan, public sector borrowing increased. Under foreign pressures, which the Japanese people have labeled as *gaiatsu* (外圧), Japan conducted three rounds of capital liberalization.<sup>16</sup> The first of these was the Kennedy Round Negotiations of May 1967, and subsequent efforts

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<sup>16</sup> Pearl, Part II, 1972. Pearl notes that *gaiatsu* for Japan's capital liberalization was coming in from two directions – foreign pressures by the OECD, to which Japan gained accession in 1963; and bilateral pressures, particularly from the United States. He also notes that Japan's then PM Ikeda gained accession without a clear understanding of what it will be required to do for membership. In other words, Japan sought for advanced nation status without expecting potential economic burdens.

were made to liberalize industries in 1969 and 1970, of which industries not on the list of liberalized industries remained subject to individual screening. The fourth round of liberalization in 1971 was somewhat different, in which a list of industries open to foreign control and a list of industries requiring individual screening for any investment (the negative list) was announced.<sup>17</sup>

But liberalized industries did not necessarily equate to free foreign investment. Neither the Japanese government nor Japanese industries were prone to expose the market to foreign control. In fact, Japan was very reluctant to open up its industries entirely based on its basic attitudes toward liberalization by the government ministries and the industries. Economic nationalism and government objectives of monetary control and administrative guidance played a huge role here. For the Japanese commercial banks which would loan to the industries for investment projects, the ministries would provide “window (*madoguchi*) guidance”, and signal the Bank of Japan (BOJ) for monetary expansion.<sup>18</sup> Foreign investors would not be subject to this tradition, and the Japanese government saw that they would be intractable in administrative guidance.<sup>19</sup>

Throughout this process, banking restrictions were the de facto capital controls in Japan. While capital outflows were gradually liberalized to contain upward pressure on the yen after 1973, capital inflows remained highly restricted in the 1970s. However, the second oil shock of 1973 placed downward pressure on the yen, and a more general relaxation of capital controls was implemented under the Foreign Exchange and Foreign

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<sup>17</sup> Pearl, Part I, 1972.

<sup>18</sup> Pearl, Part II, 1972.

<sup>19</sup> Pearl, Part II, 1972.

Trade Control Law in December 1980.<sup>20</sup> Throughout the 1980s, Japan was placed under severe foreign pressure to further deregulate its financial market.<sup>21</sup> To impose this pressure, a special committee was set up by the U.S. Treasury and the Japanese Ministry of Finance (MOF). New measures reduced restrictions on euroyen (Japanese yen-denominated deposits held in Banks outside Japan, not specifically only in Europe or in the European Union) activities and abolished limits on forward foreign exchange transactions and swaps, and the purchase of foreign securities by Japanese non-bank institutional investors.<sup>22</sup> In addition, there were domestic forces driven by the growth of the euroyen business. The twenty-year process of financial liberalization was completed in November of 1996, when Japanese Prime Minister Ryutaro Hashimoto launched the ‘Big Bang’ to finalize Japan’s financial liberalization.

### *South Korea*

South Korea duplicated Japan’s financial regime to the greatest extent amongst all Asian nations.<sup>23</sup> South Korea liberalized its financial markets bit by bit in response to the U.S. and IMF requests in the early part of 1990s, as intended by the Ministry of Finance at the time. But this semi or partial opening to foreign capital without sufficient supervision and surveillance systems ended up hurting the South Korean economy severely in the Asian Financial Crisis (AFC). During the crisis South Korea was not equipped with ample foreign reserves. Under the lax systems of financial regulation at the time, South Korean industries had been developing a habit of high debt-equity ratios,

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<sup>20</sup> Kasman and Rodrigues, 1991.

<sup>21</sup> Additionally, domestic market forces (i.e., market-driven growth of the euro-yen business) were transforming Japan in the 1980 toward financial opening to foreign economies.

<sup>22</sup> Kasman and Rodrigues, *ibid.*

<sup>23</sup> Cargill and Parker, 2001.

borrowing large sums of money to invest in high-risk projects, which in the event of a project failure, resulted in the inability to pay back the initial loan. During the Asian Financial Crisis, it was this hot money flooding out of the country that exacerbated these failures and broke down the South Korean economy. Sudden capital outflows created a domino effect of industries announcing bankruptcies, one after another. The IMF pointed at the negative aspects of the South Korean economy and demanded structural reforms of the economy as a whole, leading to tightening of public spending and corporate restructuring and thousands of workers being laid off.

Once bitten, twice shy - South Korea started amassing loads of foreign currency after its recovery from the AFC, and started to regulate capital flows after the Global Financial Crisis (GFC). It was not as hard hit during the GFC, owing to the considerable amounts of foreign exchange reserves, but it still sought to secure extra dollars via swap agreements with the U.S. Federal Reserve Board, the Bank of Japan, and the People's Bank of China. It went further to initiate a macro-prudential levy on foreign short-term capital inflows in line with the IMF's reversal of positions on capital controls, and it even considered the implementation of a Tobin tax.

In retrospect, South Korea's policy on capital and financial liberalization from the late 1980s could not be rated as strategic, and while the preventive mechanisms that it is looking into post-GFC via policy implementation for macro-prudentiality is intended in good will, it is still under skeptical views by foreign investors who consider the policies as capital controls. In a way, it may seem to the critical investors that South Korea is stepping back from its liberalization policies, but one thing is for certain – the capital

control measures are clearly different from the 1980s – that it is mainly intended to regulate hot money. Based on the changes in its financial system that it has made since then, it is also quite clear that South Korea is not retreating back to the old days of deploying strong capital controls.

### *China*

China's launch of financial reforms in recent years has been minimal in comparison to its neighboring counterparts, Japan and South Korea. It took on a very gradual and incremental step to liberalization, but considering that the Shanghai Stock Exchange did not even exist prior to 1990, China's financial sector development has been admittedly quite extensive over a short span of time. It is seeking capital liberalization via renminbi internationalization, starting with renminbi transactions with its Southeast Asian neighboring states. As for financial reforms, the Chinese Communist Party (CCP) leadership has come to the understanding that it cannot sustain growth solely based on the export-led platform on which the Chinese economy has heavily relied, and that a divergence in policy is necessary to keep the economy going.

Thus far, China has demonstrated backward ways of financial sector development that have fallen short of meeting international standards in terms of capital account liberalization, surveillance mechanisms, and transparency. Shadow banking channels have ballooned over the years due to the difficulty of financing for small and medium enterprises (SMEs); this is relevant to international finance in that foreign financial institutions are highly restricted in their ability to participate in shadow banking and domestic capital markets. The accumulation of non-performing loans (NPLs) has also

cast shadows on China's financial sector. Considering the size of its economy and scale, China's financial industry still remains largely unopened to the global economy, and as a result, China was relatively less affected by the two financial crises – the Asian Financial Crisis (1997-98) and the Global Financial Crisis (2008-09). But China has become aware of the need for financial surveillance and monitoring systems, as well as the need to make more loans available to not only the state-owned enterprises (SOEs) but also the private sector, which may enable more equal footing for SMEs via opening up. In order to undertake these tasks, China's current leadership under President Xi Jinping sees the crucial need for a financial overhaul of the economy to sustain its long-term goals of achieving high economic growth rates, as the growth rate has started to decline. Sustaining growth is also crucial for justifying the CCP's economic statecraft.

Against this backdrop, toward the end of former premier Wen Jiabao's term, the possibilities of further opening up China's financial markets were envisaged via the launching of pilot districts designated for financial reform in Wenzhou, Shanghai, and Shenzhen. Coupled with its efforts to internationalize the renminbi, China's financial reforms, now reemphasized by the current Premier of the State Council, Li Keqiang - if carried out in a systematic fashion - will have a considerable impact on China's domestic economy and foreign economic relations. China's financial reform efforts come in two forms: 'bottom-up' and 'inside-out' reforms. 'Bottom-up' reforms (rather than 'top-down' reforms), as stated by Zhou Xiaochuan, governor of the PBOC, are reflected in the designation of financial pilot reform programs, which will facilitate financing SMEs in China. The Financial Reform Pilot Districts of Wenzhou and Shenzhen, each launched in

March and April 2012, in which a set of measures including the pilot reform programs in bond, private equity and the Chinese yuan's cross-border trade, were approved by the local authorities to boost China's real economy. Market-oriented reforms of changing interest and exchange rates, and renminbi internationalization are also examples of 'bottom-up' reform.

Much of the developments on China's financial opening have been driven in large part by U.S. pressures via the Strategic & Economic Dialogue (S&ED) and other foreign pressures. While the Chinese have been eager to open the market to attract foreign direct investment for the purposes of building infrastructure and generating profit it has limited foreign investors' from investing in China's renminbi denominated capital market, allowing only a selection of global institutional investors under the Qualified Foreign Institutional Investor (QFII) program. The strongly embedded economic ties between the two states – often times referred to as 'Chimerica' – makes it very difficult for the U.S. Treasury to unilaterally demand China of U.S. requests for renminbi appreciation, and thus the S&ED platform has been more of a channel for communication for cooperation than pressure. At the executive levels, both sides understand making extreme requests will cross an invisible line and would eventually undermine future attempts for further cooperation. At the same time, both sides retain their interests (i.e., for the U.S., currency appreciation or further financial opening) and seek to bring out the most their counterpart.

All in all, for China to carry out the financial reforms from 'inside out', the first and foremost task would be to develop domestic financial markets that could generate credit from within. Accomplishing this would put the renminbi on the path to international

recognition and would also help decrease China's heavy reliance on investment and export driven growth.

### **The Responses in Theoretical Context: Institutional Variance**

#### *Why have they responded differently? Similarities and Divergence*

In answering why the three countries have behaved differently toward U.S. protectionist policies, we notice similarities in the circumstances of conflicts, and the divergence in the policy actions taken in response. The argument and findings in this dissertation lead us to the fact that institutional variance – the structure and process of policy decision-making - have resulted in the states' divergent responses. We know for sure that all three states – Japan, South Korea, and China – were operating in export-oriented economic structures and platforms, albeit with differing experiences. But more importantly, their decision-making processes and political procedures were inherently different, owing to the differing political capacity and industrial interests.

The policy responses by Northeast Asian states to each culmination of trade and currency conflicts with the U.S. differed, despite some commonalities. For example, Japan's revenue was initially primarily derived from textiles, light manufactured goods, and electronics. South Korea's case was similar in the beginning, but its exports did not penetrate the U.S. market to the same extent. China, on the other hand, started from lightweight industries but has not stopped producing lightweight products after expanding to include heavy industrial products like steel and petroleum.

Recalling the role of the state and the characteristics of its governance in the field of international political economy, there is abundant literature on the state's governing role

of the market, and its motivations and intentions backed by linkages with the industries. The seminal work by Karl Polanyi, 'The Great Transformation' (1944), was the foundation in the field of IPE recognizing that the modern market economy and the nation state are to be understood as a single human intervention under the name 'Market Society' – a socially embedded economic system and venue in which a market economy is able to function.<sup>24</sup> Susan Strange in 'States and Markets' pointed at four components of a state in constituting power – security, production, finance, and knowledge. Security was indeed one major factor that constituted power of a state (Nordlinger, 1977, 1981; Krasner, 2009; Trimberger, 1978). Strange made it very clear that a state engages in the market with certain intended purposes in mind. In the case of the U.S. approach to Northeast Asian states, as we know, certain mutual interests were met in terms of both security and economic benefit. Political scientists and economists have thus far explored the linkages between the state and its economic behavior. Marina Arbetman and Jacek Kugler have argued that political capacity captures the ability of political systems to carry out the tasks chosen by the nation's government in the face of domestic and international groups with competing priorities, and that governments increase their political capacity by expanding reach over the population or by extracting more from groups already mobilized.<sup>25</sup>

What I seek to emphasize before delving into the concept of institutional variance, by comparing the cases of these three countries, is the importance of the role of the state in the process of policy outcome. The cases of East Asian industrialization are not an

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<sup>24</sup> Polanyi, 1944.

<sup>25</sup> Arbetman and Kugler, 1997.

exception - the literature on the industrialization of Japan, South Korea, and China, reveals the critical role of the state in the process. The institutional ways and means of resulting in a policy outcome is decided by the state. But each country's case tells us that institutional variance lies in the different combinations of structure and process created by different actors – the central government, political leaders, the bureaucracy, industries, and the general public – having different weighted influence on the final outcome in foreign economic policymaking.

Previous literature has emphasized the role of the state in East Asian economic development. Alexander Gerschenkron argued that the later a country industrializes in chronological history, the greater the economic interventions of the government, because production methods become more capital-intensive, calling for a larger role of the state to make arrangements for required capital.<sup>26</sup> The East Asian cases have often times been characterized by strong intervention of the markets by the government, as Robert Wade explains in 'Governing the Market'. Wade argued that East Asian governments went far beyond the limits of "good" neoclassical intervention in the course of development.<sup>27</sup> The government played a significant role in allocating resources and deciding on the directions of development in specific strategic sectors in the East Asian cases. They were also very systematic in carrying out the tasks on the path of development. Chalmers Johnson in 'MITI and the Japanese Miracle' focused on the Ministry of International

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<sup>26</sup> Gerschenkron, 1962. Later, Amsden came up with a twist on his original thought and suggested that the later a country industrializes in chronological history, the greater the probability that its major manufacturing firms will be foreign-owned (Amsden, 2001). China's economic development was made possible largely via foreign direct investment, although it now possesses several SOEs that are mainly owned by Chinese shareholders. China's FDI dependency is more striking when one takes into account the substantive investment roles by SOEs (Huang, 2003).

<sup>27</sup> Wade, 1990. p.342

Trade and Industry (what is now METI) as the leading agent among many Japanese bureaucratic agents in the Japanese economic system. Alice Amsden in 'Asia's Next Giant: South Korea and Late Industrialization', also pointed out that the South Korean government was able to avoid backwardness by government coordination of economic activities.<sup>28</sup> China's paths were somewhat different, but Deng Xiaoping's decision to open up the economy to foreign direct investment was the starting point. In filling in the answers as to how a communist China was able to grow, Yasheng Huang notes that foreign direct investment was key to China's development, and stresses that China's TVEs in the 1980s that were *de facto* private firms (not public enterprises) which ceased to exist in the 1990s in the rise SOEs when national policy environment became inhospitable toward rural entrepreneurship (Huang, 2003; 2008).<sup>29</sup> The TVEs in the early phase of Chinese development were critical in putting China on the path to development, but it is difficult to deny the presence of the state throughout the phases of development. It was the state that made the initial decisions to open up, and when local enterprises performed well, it took over with the SOEs. Simply put, the state in East Asian industrialization was indeed a facilitator and determinant of economic growth. Political leadership, bureaucracy, and government-business relations played a central role in propelling economic development in the three countries.

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<sup>28</sup> Amsden, 1992.

<sup>29</sup> Huang, 2008. p.72. Truth be told, after Deng Xiaoping stepped down, Jiang Zemin's leadership (including the Shanghai clique, his political faction consisting of people who have previously worked for or were associated with his administration in Shanghai) pushed for stronger roles by the coastal provinces to become the headquarters of development rather than continuing with the rural entrepreneurs. Born and raised in Jiangsu, adjacent to Shanghai, Jiang's education and previous posts in Shanghai also add personal initiatives to develop the region.

What I seek to do in this dissertation is to go beyond the previous literature on the role of the state and dissect the differences in institutional mechanisms of each East Asian state in response to U.S. protectionist policies. When each East Asian state outperformed U.S. expectations and U.S. protectionist measures confronted each East Asian economy, it was also up to the East Asian states to decide how they would respond. In the Peter Gourevitch explanation, this was ‘second image reversed’ for many states. International sources would be influencing domestic political factors, and states had to come up with responses that would satisfy the opponent and the home industries.

The crux of the argument in this dissertation is that the nexus of political capacity and industrial interests are the underlying factors to institutional variance – the divergence of pathways and responses to U.S. protectionism. They were used to explain the developmental models, but they remain relevant to solving the puzzle here: the divergence in the policy decisions that were made to respond to external pressures. Political capacity is the foundation for decision-making by leaderships and bureaucracies; industrial interests are the sources of the directions in policy, as they are what politicians provide directions for and must in turn defend in order to gain electoral gains. In the absence of these two factors, it would be difficult to explain why the states chose to respond differently.

The underlying assumption would be that in the event of an external pressure, states would try at the utmost of their political capacities to protect domestic industrial interests. Douglass North sought to explain the disparity in the performance of economies, and the persistence of disparate economies through time by focusing not only on economic

variables but institutional variables.<sup>30</sup> I find the roots of my argument stem from North's. The degree of U.S. pressures imposed on each country though obviously different, were not the ultimate factor that created the divergence in the responses. The divergence of East Asian institutional capabilities and specificities lies in the structure and process of policy decision-making.

### *Alternative Explanations of East Asian Responses to U.S. Protectionism*

There are alternative explanations for the varied responses to East Asian responses to U.S. protectionism. There is the question of scale, and the question of size – the East Asian states have different economies with different fundamentals, and have had different pathways of development, as mentioned in the China case. While these variables are given beyond a social scientist's control, there are some explanations – geopolitical, constructivist, and socio-cultural – that deserve scholarly attention.

#### *Geopolitical Explanations*

Given the nexus of security and economic interests that the U.S. had since the two World Wars and the Korean War, many would contest the idea that U.S. foreign policy on Northeast Asia was built only on economic interests. I.M. Destler writes that liberal U.S. trade policies were further buttressed by concerns of countering the threat of communism, and that military alliances with Western Europe and Japan were the sources of containing the USSR and the PRC.<sup>31</sup>

The U.S. provided massive aid to its allies and made the start of the Japanese economic miracle possible. The increasing demands of special procurement also sped up

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<sup>30</sup> North, 1990.

<sup>31</sup> Destler, 2005.

the economic reconstruction. In the outbreak of the Korean War, Japan, which did not take part in the war after its surrender in the WWII, was able to take full advantage of its geographical proximity to convey necessities and defense products for the allied forces, thereby adding the revenue from the war to its economic development. South Korea had a similar experience of converting a part of the remittances of its soldiers who participated in the Vietnam War into South Korean highways construction.

The dynamics of geopolitical linkages between the U.S. and East Asian states have clearly existed, and continue on to this day. But the geopolitical explanation falls short of clarifying the causes of variance in the responses from each country in which the security situations grew less intense compared to the initial days in the Cold War in which security interests were top priority. Moreover, the culmination of bilateral trade and currency conflicts between each of the East Asian states and the U.S. was during periods in which Cold War security dynamics remained or security interests existed but were not top priority – Japan in the 1970s and 1980s, South Korea in the 1980s and 1990s, and China in the 2000s and 2010s. The previous decades of economic prosperity and growing interdependence prompted the security environment to change, partially contributing to the previous decades of absence of war. For instance, it is difficult to state that Japan adhered to the wishes of the U.S. in the Plaza Accord due to strategic interests. It is also difficult to say that South Korea accepted the conditions for liberalization in the IMF guidelines after years of U.S. pressures on its currency appreciation because of South Korea's strategic security alliance with the U.S. Inevitably, North Korean nuclear threats still remain vital to South Korean political decision-making, but they were not strong

enough to compel foreign investors to pull out of South Korea. Rather, it was the South Korean lack of soundness in its financial systems that compelled them to pull out. It is thus an overstatement to say that security interests overrode economic interests in U.S.-East Asian relationships from the 1970s and onwards.

In other words, we need a framework to explain the ultimate interests that contributed to each of the responses from the three states, and the variance in the response of these states was distanced from the geopolitical explanation. Because security and economic interests go hand in hand the geopolitical explanation may serve as the main pillar of understanding security dynamics in bilateral and regional relationships between the U.S. and each of the Northeast Asian economies – China, Japan, and South Korea. But the internal dynamics of industrial interests and political decision making processes are the fundamental sources of foreign economic policymaking. These institutional factors need to be elaborated upon in order for us to understand the ultimate reasons as to why responses have varied.

*Constructivist Explanations: Learning Processes and Legal Expertise*

A curious examiner could question the legal capacity of states in filing counter lawsuits when faced with protectionist measures. Could it be the case that over time, Northeast Asian states have acquired the ability to defend themselves against U.S. accusations of wrongful trading acts and currency manipulations, but have differed in that legal capacity? Taking Japan's litigant behavior in the WTO as an example, Davis shows that explaining Japan's actions in the WTO with the constructivist view is fairly difficult – it is true that Japan has had a relatively less litigious culture and lack of low legal

capacity in Japan. She argues that if we assume that Japan is averse to litigation, the variation of Japan's litigation over time cannot be explained; moreover, she points out that there is little correlation between domestic legal changes and Japanese litigation in the WTO. Both South Korea and China have shown an increasing emphasis on expanding the legal capacity and learning process for dealing with trade disputes. It is only natural that a country would pursue the learning process when encountering a new challenge. Recognizing that there is a learning process is important, but what is more critical is the realization this learning process is only a fraction of the whole process of policy decision-making.

The old explanations (please see note) of Asians seeking to avoid conflict in court does not really give a sufficient answer here, because we have seen these states actively engaging in trade disputes in the WTO in order to defend their interests.<sup>32</sup> Legal expertise requires time to accumulate, and as states gain experience in international courts they also gain legal expertise. But legal learning does not guarantee or decide a state's defense or offense in response to a waged trade or currency conflict.<sup>33</sup> Rather, legal tools are the means to protect industrial interests, and it is better played when political capacity is present to support the exercise of legal tools. In other words, the learning process is only a small part of the institutional toolkit for states, and cannot explain for the whole framework of policy decision-making.

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<sup>32</sup> Zhang, Qi. 2007. Zhang argues that for China, Confucian morals and traditions keep the Chinese away from engaging in conflict in any manner, especially in court. He explains that this is the fundamental explanation to why the Chinese government has been actively in pre-consultation stages of the WTO dispute settlement, prior to actual consultation stage and before panel establishment.

<sup>33</sup> Davis, 2012. pp. 190-194.

### *Socio-Cultural Explanations*

As a student of Northeast Asian studies focusing on the three countries of Japan, South Korea, and China, it is very easy to compare certain behaviors and critique or even joke about certain mannerisms or fixed attitudes that one may encounter in the three states as a researcher. These three states differ a great deal in terms of culture, no matter how deeply the influence of Confucianism and previous past encounters are deeply rooted in their histories. But this knowledge does not help us to answer why the three states differed in their responses to U.S. protectionist measures. States construct their defenses not in a socio-cultural way, but based on strategic and economic thinking against such measures. Socio-cultural explanations may come into play when explaining the characteristics of bureaucrats as individuals and the construction of the bureaucracy, but not in terms of the goals of ultimate decision making for policy. But, just as the constructivist explanations are only a small part of the institutional toolkit for the states, the socio-cultural explanation of bureaucracy is only a portion of the institutional process and structure.

As demonstrated in **Figure 1-1**, there are five stages in the East Asian States' bilateral economic relationships with the United States. These stages are the common denominators in the relationship between each state and the U.S. during the postwar period. These similarities provide good ground for comparison of the East Asian countries' experiences and divergence of policy responses. How they differed in their responses in trade and currency conflict with the United States, owing to institutional variance, is laid out in the brief argument **Table 1-1**.

**Figure 1-1. The Five Stages of U.S.-Northeast Asian Trade Wars and Currency Conflicts**



Source: By author

**Table 1-1. The Argument in Brief: Key Variables in U.S.-Northeast Asian Trade Wars and Currency Conflicts**

Background	Independent Variable (IV)	Dependent Variable (DV)
U.S. Protectionism via Trade Wars and Currency Conflict	Various Structures of Foreign Economic Policymaking	Responses from Japan, South Korea, and China
<b>Trade Dispute Initiation</b> <ul style="list-style-type: none"> <li>✓ Recurrence of trade imbalances</li> <li>✓ U.S. losses in comparative advantage</li> <li>✓ Antidumping and Countervailing Duty Investigations by the USITC / USDOC</li> <li>✓ WTO Dispute Initiations by the USTR</li> </ul>	<ul style="list-style-type: none"> <li>• Regime type</li> <li>• Government related actors: political parties, politicians, ministries and bureaucrats</li> <li>• <b>Bureaucratic decision making structure:</b> political and economic agenda-setting and actions by actors</li> </ul>	<b>Responses to Trade Disputes</b> <ul style="list-style-type: none"> <li>➢ Japan: Strategic acquiescence due to strong bureaucracy led by MOF and METI</li> <li>➢ South Korea: Reciprocation via the omnipotent presidency that drives ministerial policy coordination amongst MOTIE, MOFA, and MAFRA</li> <li>➢ China: Retaliation under a hierarchical system with the Politburo as the influencer and MOC as the agent</li> </ul>
<b>Currency Appreciation Pressures</b> <ul style="list-style-type: none"> <li>✓ Appreciation of the U.S dollar, relative depreciation of the currencies of trading partners</li> <li>✓ Pressures for financial opening coupled with currency appreciation pressures</li> </ul>		<b>Responses to Currency Conflicts</b> <ul style="list-style-type: none"> <li>➢ Japan: Strategic Compliance by the MOF (Plaza Accord, 1985; Louvre Accord, 1987; Smithsonian Agreement)</li> <li>➢ South Korea: Lack of strategic behavior by the MOF (1988-1992), Accidental depreciation in the AFC</li> <li>➢ China: Combined strategies of resistance and incremental appreciation of the renminbi by the PBC (2005-2013)</li> </ul>

Source: By author

## **Mechanisms and Plan of the Dissertation**

This introductory chapter has laid out how I approach trade wars and currency conflicts between the U.S. and its Northeast Asian counterparts at different points in time: Japan in the 1970s and 80s, South Korea in the 1980s and 90s, and China in the 1990s and 2000s. The following chapters unravel each bilateral conflict under a certain segment of the conflict in each chapter.

Chapter 2, *'Theoretical Framework: Political Capacity and Industrial Interests'*, provides an explanation of each country's decision-making process and structure in responding to U.S. protectionism. Decisions made by these East Asian bureaucracies shared some similarities, in that all three took industrial interests very seriously, hoping to promote continual high-speed growth. But the ways and structure in which they made their policy decisions were disparate. The actors and the embedded factors in their decision making processes are laid out by country cases: government regime type, government related actors consisting of political parties, politicians, ministries and bureaucrats, and political and economic agendas and actions resulting in bilateral political interactions and diplomatic actions with the United States. Industrial interests are explained by country cases in terms of government-business relationships. I present my model of institutional variance by presenting the three different policy-making structure models for each country.

Chapter 3 and 4 are the core chapters on trade disputes. Chapter 3, *'Trade Wars: East Asian Responses to U.S. Protectionist Actions, 1971-2013'* examines three bilateral chronologies of U.S. antidumping and countervailing duty investigations on Japan, South

Korea, and China. This chapter finds that with the motivations of the United States International Trade Commission (USITC) and the United States Department of Commerce (USDOC), antidumping (AD) and countervailing duty (CVD) investigations were pursued from the 1970s, with the intent to pressure U.S. trading partners generating U.S. trade deficits. The explanations for the varied trade remedy structures of each East Asian state demonstrates how each state coped with U.S. pressures based on its individual political capacity and industrial interests.

Chapter 4, '*Trade Wars Continued: East Asian Responses to U.S. Protectionist Actions in the WTO, 1995-2013*' analyzes a) how the amount of trade deficit accumulation with a trading partner leads to a political consensus for protectionist measures, and ultimately, the filing of a dispute settlement case in the WTO, and b) how the varying domestic institutional preparations for WTO litigation in the three East Asian countries has resulted in different responses to U.S. WTO dispute initiations. In the first part, a quantitative regression model is deployed to highlight the statistical significance of the U.S. trade deficits/annual GDP ratio with regard to U.S. protectionist measures. In the second part, WTO dispute cases between U.S.-Japan, U.S.-South Korea, and U.S.-China bilateral trade relations provide examples to supplement explanations for the institutional variance in East Asian responses to U.S. WTO dispute initiations, as well as three countries' own patterns of participation in the WTO dispute settlement body. I argue that responses to WTO dispute initiations by the U.S. have varied as a result of the differing bureaucratic structures for foreign economic policy making: I find that Japan has acquiesced due to its high delegation to the trade ministry technocrats that are not well-

equipped in terms of financial resources or policy priority in regard to trade disputes; that South Korea has reciprocated owing to demand for the omnipotent presidency to be very conscious of public opinion on trade matters to ensure successful ministerial policy coordination and public-private legal partnerships; and that China has retaliated based on its top-down decision making structure (Politburo-State Council-Ministries) under which the Ministry of Commerce is enabled to prioritize trade dispute matters, and is empowered and provided governmental support for pursuing disputes at the discretion of the Vice Premier in charge of foreign economic affairs.

Chapter 5, '*Currency Conflict: East Asian Responses to U.S. Currency Appreciation Pressures, 1971-2013*' analyzes why the three countries have responded differently to currency conflict with the United States at the height of their industrialization. U.S. bilateral trade deficits with East Asian economies have led to the imposition of political pressures for currency appreciation on countries with trade surpluses, which have maintained currency and capital controls under highly regulated financial systems. Simultaneously, coercive bilateral negotiations were convened to promote financial liberalization and deregulation. I find that Japan acquiesced in the Plaza Accord and the Big Bang, strategically looking to play a larger role in the global economy until their bubble economy burst. South Korea also acquiesced somewhat initially, but reciprocated without strategic planning, which resulted in an unprepared financial opening, and ultimately, accidental depreciation of the won during the Asian Financial Crisis. In recent years, China has been facing and resisting the same pressures, but has different answers

backed by differing motivations. China seeks to launch financial reform on its own terms, including capital liberalization to push for renminbi internationalization.

Chapter 6, *'The Change of Tides: The Future of U.S.-Northeast Asian Trade Wars and Currency Conflicts'* is a concluding chapter that summarizes these findings and projects the future of trade and currency conflicts. Such conflicts are unavoidable in our global economic system, and deserve particular attention as they occur daily. Intra-regionally, the U.S. 'Pivot to Asia' is fabricating a series of regional contestation and rivalry with China. I question whether the ongoing negotiations for the Trans-Pacific Partnership agreement will play a role in consolidating U.S. presence in the region, and how China, Japan, and South Korea will continue to vie for financial and economic interests in Northeast Asia. I also present some avenues for additional future research.

## CHAPTER TWO

### Political Capacity and Industrial Interests In Theoretical Context

Institutions are the humanly devised constraints that structure political, economic, and social interaction.

- Douglass North, 1991-

Accountability without authority only brings refusal of countenance,  
and authority without accountability only brings administrative totalitarianism.  
권한없는 책임은 면피주의를 낳고 책임없는 권한은 행정독주만을 불러일으킬 뿐이다.

- Horace George Frederickson -

Confucian bureaucracy and democratic self-government  
are not only compatible with economic growth,  
but they may also be a powerful mix of economic, bureaucratic, and democratic ideas.

- Francis Fukuyama, 'Trust', 1995 -

### **Theoretical Framework: Institutions that Matter**

In countries around the world, institutions and bureaucracies frame and construct the patterns of political decision-making processes, and the particularities of institutions serve as the main pillars and foundations of policy formation. They are webs of complexities, involving the interests of the ministries as pillars of the government, and also individuals - politicians and bureaucrats. Institutions are established pursuant to a certain objective, which continues to lead and push the decision-making process toward a certain intended direction. This is especially applicable to trade and financial decision making processes. Ministries act in cooperation and conflict as they interact with one another and encounter their vested interests. For instance, in the case of the Ministries of Finance in Japan and South Korea, a ministry may have a conflict of interest with another governmental ministries, or with the central bank (which, strictly speaking, is not a government ministry in Japan or Korea, but is in China).<sup>34</sup> The power dynamics that exist between institutions will also contribute to the final policy outcome.

Meanwhile, individuals – politicians and bureaucrats alike – also retain their own vested interests in building their careers while interacting with one another during over the course of policy formation. Their behaviors also impact the direction of policy. Interpersonal activities and interactions amongst political leaders and ministry officials influence the policy decision-making process, and must incorporate both organizational and individual interests. Asian bureaucracies, in particular, have been criticized for three shortfalls – i.e., in the South Korean case, 관치금융 (官治金融: government-controlled

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<sup>34</sup> China's Ministry of Finance has lesser leverage in policy than the PBOC in reality), or the politicians involved in the decision making process.

finance), 면피주의 (面皮主義: face covering), 복지부동 (伏地不動: to have an apathetic attitude) – which have hindered the improvement of government performance in policy agenda setting and implementation.<sup>35</sup> These traits are commonly found elsewhere in the bureaucracies of Asia, including Japan and China.

In the previous chapter, I emphasized the concept of political capacity as the main factor leading to institutional variance. The existing literature on political capacity has approached this issue from various perspectives. Some scholars have approached the concept with a broad perspective on democracy or the rule of law. Feng analyzed the concept in terms of the three major dimensions of a political system – political freedom, political stability, and policy certainty – he then related to them to economic development.<sup>36</sup> Meanwhile, I find my argument closely aligns with the concept of political capacity defined by Arbetman and Kugler in ‘Political Capacity and Economic Behavior’.<sup>37</sup> They define the aggregate performance of governments, as the ability of political systems to carry out the tasks chosen by the nation’s government in the face of domestic and international groups with competing priorities, which can be approximated as political capacity. Building on Arbetman and Kugler’s previous work, I propose a framework that consists of institutional variance stemming from differing political capacities in Japan, South Korea, and China’s policy responses to U.S. protectionism. In order to compare and analyze institutional variance among the economic and financial

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<sup>35</sup> Han’guk Kyōngje Sinmunsa, 1994. *Ilson kyōngje kijadul i pogo ssun Han'guk ūi kyōngje kwallyo*. Sōul-si: Han’guk Kyōngje Sinmunsa. Written by groups of economic and financial journalists in South Korea, the book points at the malpractices of South Korea’s economic and financial ministries in the past decades toward the outbreak of the Asian Financial Crisis.

<sup>36</sup> Feng, 2003.

<sup>37</sup> Arbetman, Marina and Jacek Kugler, 1997.

decision making processes in these three countries, the ideal framework should not only include political regime types and bureaucratic characteristics, but also any political transitions, and specific decision-making structures in the bureaucracies with government-business relations.

In each of the three countries of study – Japan, South Korea, and China – who decides, who follows, and who contradicts in the making of economic and financial policies can vary significantly depending on domestic decision-making structures and bureaucratic nature. Many scholars in the field of East Asian political economy have examined decision-making power structures and bureaucracies in depth for a particular country. Their findings have become strong foundations for the study of political economy in each of these countries. The seminal work by Grimes (2001) on Japan's macroeconomic policy failure from the Plaza Accord to the bubble economy, the analysis by Schoppa (1997) on Japanese trade policymaking and negotiations with the United States, the works by Mulgan on Japan's agricultural lobbying and agricultural policy regime (2000; 2006), and the work by Shih (2008) on the political factions in the financial decision making process of China are good examples of such analyses in the literature. Analyses of policy formation in terms of South Korea's economic development are widespread, but analyses of South Korea's policy responses to trade and currency conflicts remain quite limited in comparison to those available in the Japanese and Chinese cases; Further, most of the literature examining the case of South Korea's focuses on the period just before and after the Asian Financial Crisis, rather than the late 1980s when South Korea initially received U.S. pressures. Filling this gap in the South Korean case, and

furthermore explaining the divergence of policy responses amongst the three countries, would be the fundamental goals of this project. The stark differences between the three countries' internal policy making structures, when it comes to who has the upper hand in policy making in matters of trade and finance policy, can result in divergence in the behavior and final actions leading up to a policy response to external factors – i.e., U.S. protectionist measures and pressures.

### **Analytical Framework: The Pathways to Policy Formation**

#### *Argument*

I make a two-level argument. First, I argue that with regard to U.S. trade protectionism in the form of political pressures, the three industrialized East Asian economies under consideration have responded in very different ways. The varied outcomes of trade policy responses to U.S. protectionism – Japan in acquiescence, South Korea in reciprocation, and China in retaliation - have depended largely on respective policy making structures and processes (Chapters 3 and 4). Second, I argue that in encountering U.S. currency appreciation pressures, the three countries have again responded differently, because of each state's existing policy-making structures and processes – Japan with strategic acquiescence, South Korea with resistance and lack of strategy, and China with combined strategies of resistance and acquiescence based on calculations of its economic interests with the United States (Chapter 5).

#### *Explaining Policy Variation*

My core argument in explaining the variations of policy responses to U.S. protectionist policies amongst Japan, South Korea, and China, is based on varying

characteristics of policy-making structures, actors involved in these processes, and the connection to industrial interests. My argument is based on the premise that the political capacity of each state is critical to policy formation, and is vital in terms of creating the variations in policy outcomes amongst the three countries I propose a theoretical framework of government decision-making processes toward economic and financial policy implementation in each of the three countries. I seek to make comparisons beyond description of each country's systems, and how this divergence determines final policy outcomes. In doing so, I pay very close attention to the characteristics of political systems, the ministries, the decision makers, and the mobilization of interests. I carefully trace the role of ministries and individuals – political leaders and officials – and the leverage that they have under their own political systems. In my explanations, the political organism that the ministries and the political leadership share, extends to the business world, thereby demonstrating how industrial interests are interlinked with the formation of policy. I reflect on government-business relations in the making of policy, which deserves careful attention in the countries of observation.

### *Methodology*

My hypothesis suggests that the structures and processes of policy formation in East Asian states ultimately leads to the final outcome of policy responses against U.S. protectionism. The political capacity of the state is an inherent factor that influences the structures and processes. In explaining the varieties of policy responses, I provide a country-by-country analysis for the each country, based on the time periods in which bilateral trade and currency conflicts were culminating. I analyze political systems,

ministries and decision-making structures, bureaucratic performance (by ministries and officials), and industrial interests linked to the policy making process. The subsequent chapters are organized by important themes and subcategorized by each country's analysis and comparison.

I deploy qualitative methodology based on in-depth field research in the East Asian countries of my study, and also partial quantitative work in my methodology. My analysis is based on a process-tracing method involving economic data and figures. Therefore the analysis is easily approachable by interdisciplinary readers. The quantitative portion of my analysis is found in Chapter 4, in which I present the results from a time series, cross-sectional, data analysis of the impact of U.S. trade imbalances on U.S. dispute initiation in the WTO. The dissertation is grounded in three years of research, including pre- and post- dissertation fieldwork research and on two solid years of on-site fieldwork encompassing four countries – the U.S., Japan, South Korea, and China. The archival research and interviews I conducted were mainly in the native language of each of the three countries, over the course of two years. During this time I worked comparatively across different national settings, integrating insights derived from data observations in both archival research and figure-based analyses.

My on-site field research consisted of a series of personal interviews with important government officials, scholars, and policymakers; and archival research in each country. I started my research in Japan as a Visiting Research Fellow at the Institute of Social Science, at the University of Tokyo, with research guidance from Professors Nobuhiro Hiwatari and Keisuke Iida (2010-11), and as a Visiting Scholar at the Policy Research

Institute (PRI), at the Ministry of Finance, Japan (2011).<sup>38</sup> Graduate seminars held by Professor Iida on Japan's trade policy and seminars by Professor Takatoshi Ito on Asian financial markets were helpful in tracing Japan's policy stance on trade and finance in recent decades. Seminars held by government officials turned professors – Shinichi Nakabayashi on fiscal policy, and Shōtarō Oshima on Japan in the WTO – and central bankers from the Bank of Japan sparked my interest in Japan's policy world. I was then motivated to pursue a visiting research position in Kasumigaseki – Japan's bureaucratic district in Tokyo – for the latter half of my stay in Japan. While at the Ministry of Finance in Japan, I met and interviewed numerous Japanese politicians and government officials in the Bank of Japan (BOJ), the Ministry of Foreign Affairs (MOFA), the Ministry of Finance (MOF), and the Ministry of Economy, Trade and Industry (METI). Regular seminars held at the PRI of MOF and the RIETI (Research Institute of Economy, Trade, and Industry) of METI were very informative and instrumental to adding knowledge and deepening my understanding of the issues concerning the current Japanese economy. This was especially important after the 3.11 earthquake, tsunami, and Fukushima nuclear plant incident, which coincided with my fieldwork in Japan.

I continued my fieldwork as a Senior Visiting Research Student at the School of International Studies at Peking University (PKU) in China, with research guidance from Professor Wang Yong (2011-12). At Peking University, I benefitted greatly from

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<sup>38</sup> Some of the most important and memorable figures I met and interviewed in Japan were Kawaguchi Yoriko (Former Minister of Foreign Affairs), Tanaka Hitoshi (Former Deputy Minister of Foreign Affairs), Nakao Takehiko (Former Vice Minister of Finance), Oshima Shōtarō (Former Director-General for Economic Affairs in the Ministry of Foreign Affairs and Former Appellate Body Member of the WTO Dispute Settlement Body), Takashi Shinohara (Former Senior Vice Minister of Agriculture, Forestry and Fisheries).

graduate seminars held by Professor Wang Yong at the School of International Studies on US-China trade relations, and Professor Michael Pettis at the Guanghua School of Management on China's finance and business. At Tsinghua University School of Economics and Management, the lectures by Professor Li Daokui – one of the academic members of the Monetary Policy Committee under the State Council – enhanced my understanding of the Chinese perspective regarding both U.S-China bilateral economic relations and the Chinese economy as a whole. Although it was systematically difficult to meet and interview top Chinese government officials while residing in mainland China, with effort scholars at major Chinese universities and the Institute of World Economics and Politics (IWEP) of the Chinese Academy of Social Science (CASS) – which operates directly under supervision by the Chinese political party's initiatives – were accessible.<sup>39</sup> As a foreign researcher, the research environment of mainland China was the most challenging of the three countries, mainly due to difficulty accessing data. However, during the course of my stay I was able to build personal networks (*guanxi*) that created opportunities to speak with bureaucratic officials, professors at PKU, and other universities in Beijing, who worked closely with the ministries in China. I also encountered government officials from the Chinese Ministry of Commerce (MOC), the State Administration of Foreign Exchange (SAFE), and the People's Bank of China (PBOC) while on educational training in the U.S., for off-the-record conversations.

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<sup>39</sup> Among numerous important academics I met and interviewed in China were Professors Wang Jisi (Peking University), David Li Daokui (Tsinghua University), Chen Zhimin (Fudan University) and Song Guoyou (Fudan University).

In between my fieldwork in Japan and China, I conducted additional fieldwork in Seoul, South Korea (2012), collecting archival data from the National Assembly Library and interviewing some government officials at the Ministry of Finance, the Ministry of Strategy and Finance (MOSF), the Ministry of Foreign Affairs (MOFA, formerly MOFAT), and the Korea International Trade Association (KITA). These ministries are located in different spots around Seoul, in Gwacheon (the outskirts of Seoul), and in Sejong City.<sup>40</sup> On one note, I encountered some of the bureaucrats whom I made contacts with at different fieldwork sites in places distant from their home bases. I would meet Japanese and South Korean bureaucrats stationed in Beijing, or South Korean bureaucrats in Tokyo. Japanese and South Korean bureaucrats who are young in their profession were accessible while they were on educational training in the Boston or D.C. area, but many Chinese bureaucrats who were in the U.S. were in mid-career or senior level professionals. Many of my interviewees (many of whom were Chinese) asked to be off-the-record. The ubiquity of Northeast Asian bureaucrats in my various fieldwork sites enabled far more multi-layered research than expected.

### *Data*

I make use of two types of systematic comparisons to analyze the causality of the argument. First, in reference to John Stuart Mill's Method of Difference, I conduct an atemporal national comparison to analyze differences across the three countries.<sup>41</sup> In the

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<sup>40</sup> After my fieldwork was completed in South Korea, many important ministries (i.e, the MOSF) have relocated from the Gwacheon Government Complex to the new Sejong Special Autonomous City Government Complex.

<sup>41</sup> See John Stuart Mill, 'A System of Logic, Volume 1', 1843. In comparative politics, Mill's Method of Difference is commonly understood as Most Similar System Design (MSSD). The method of difference identifies the independent variable that causes the difference of the values of the dependent variables –

big picture, the three countries of study are countries that have commonalities in economic development via export-oriented growth, with similar cycles of U.S. protectionism imposed on them. However, they diverge greatly in terms of the institutional characteristics that embody political capacity.

Second, to prove the significance of trade deficits in propelling political action toward protectionism in the U.S. government, I conducted a large-N analysis of U.S. trade imbalances with specific trading partners as a percent of annual GDP and U.S. initiation of trade disputes (Chapter 4). Statistical modeling is presented using quantitative data from the U.S. Bureau of Economic Analysis, the U.S. Census Bureau, the WTO, the IMF, the OECD, and the World Bank, centering on countries that are main U.S. trading partners and/or have been involved in a trade dispute with the U.S.

In all three country case studies, I rely upon three main sources of data: first, my personal interviews with key political actors (politicians, bureaucrats, business representatives, financial leaders); economic and financial data issued by the four governments involved in the study (U.S., Japan, South Korea, China); and official reports issued by international economic research institutions, newspaper articles, written articles and speeches, and local literature from national archives. I have perused WTO and USITC/USDOC data and case reports for detailed quantitative analyses, and data

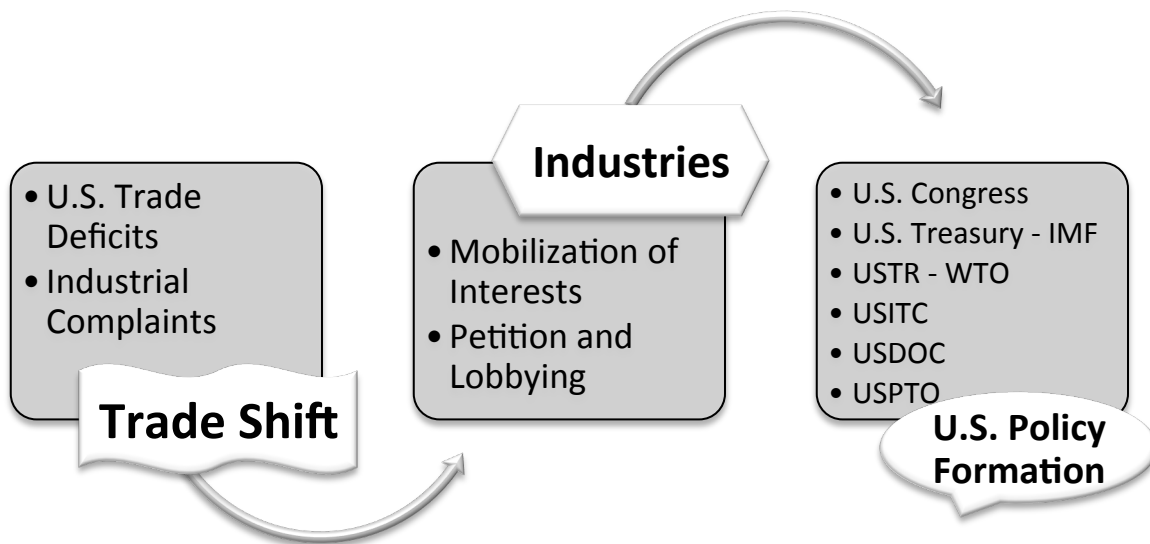
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which, in this case, are differed institutions (IV) and policy responses (DV). Some major works in comparative politics by Gabriel Almond and Sidney Verba (*The Civic Culture*), Theda Skocpol (*States and Social Revolutions: A Comparative Analysis of France, Russia, and China*), and Giovanni Sartori (*Parties and Party Systems*) have stemmed from Mill's Method of Difference. More recently, political scientists in fields of comparative politics and international relations such as Yves Tiberghien (*Entrepreneurial States: Reforming Corporate Governance in France, Japan, and Korea*) and Dorothy J. Solinger (*States' Gains, Labor's Losses: China, France, and Mexico Choose Global Liaisons, 1980-2000*) have worked on the role states and the market applying Mill's Method of Difference.

produced by government agencies of Japan (MOF, METI, MOFA, BOJ), South Korea (MOSF, MOTIE, MOFA, BOK), and China (MOF, MOC, MOFA, PBOC).

Lastly, I have relied heavily on the personal memoirs of politicians and technocrats in the three countries – all of them are official published memoirs written by either political leaders or elite participants in the trade and financial policy process. Some of the useful memoirs available on China include those by Zhu Rongji (former PBOC Governor and Premier), and Chen Jinhua; on Japan, by Takeshita Noboru (former Minister of Finance and PM), Eisuke Sakakibara (former MOF official); on South Korea, Kang Man-soo (former Minister of Finance) and Park Chul-un (former Blue House Policy Adviser) among many others. Memoirs by U.S. politicians fall relatively short of explaining the details of bilateral policy interactions, but I have included them in my research where they proved useful. Tracing the pathways of policies in the making of these three different bilateral relationships is a time-consuming yet intellectually stimulating process. I have tried to demonstrate how each policy interaction was conducted in the simplest way possible for future researchers to carry on from where I left off.

**Figure 2-1. Analytical Framework of Trade Wars and Currency Conflict:  
The Formation of U.S. Policy on the Three Countries**



**Figure 2-2. Analytical Framework of Trade Wars and Currency Conflict:  
Formation of Japan, South Korea, and China’s Policy Responses to the U.S.**



## **The Logic of Policymaking and Policy Outcome**

The effects of policymaking on policy outcomes have been steadily examined by many scholars in the fields of comparative politics and international relations. With regard to foreign economic policymaking, there is abundant literature on a single country case study in the field of IR, especially in the case of the U.S. government, or many comparative studies of the functionalities of the U.S. and European governments.<sup>42</sup> There is also plentiful literature on the policy decision making patterns of Northeast Asian states, largely in the forms of single-country or two-country case studies. The majority of these studies have been on Japan, and in recent years, on China; but to date, there is not as much literature covering South Korea.

### *Bureaucratic Capacity*

In delivering the argument that institutions matter in policymaking, and that the pathways of institutions shape state behavior in policy actions, it is important to reexamine the literature on the role of states and institutions. By institutions, I refer to domestic institutions rather than supranational or international entities that have global institutional functions, because the focus of my argument is centered on the state and institutions that serve as operational pillars of the state in making and implementing policy. Of course, the states as the subjects of this study – China, Japan, and South Korea – have bureaucratic systems that vary and derive from the ideological roots in their political systems. According to Gourevitch (1986), among the five policy options of the state (classical liberalism, socialization and planning, protectionism, demand stimulus,

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<sup>42</sup> Cohen, Paul and Blecker, 2003.

and mercantilism), the basis of economic policy options of the state can be categorized mainly into two ideological roots – classical liberalism or socialization and planning – as policy prescriptions. Naturally, each state has had different levels of state involvement in the economy. Japan from the 1970s to 1980s was operating on a free market economy system with considerable state involvement. But so was South Korea in the 1980s and 1990s and China in the 2000s and 2010s– although China has been maintaining stricter government control over its economy than other two East Asian states. While the proportion of state involvement in the overall economic activity may matter a great deal, ideological representations of the state and political systems provide us with only a small fraction of the explanation we are aiming for in terms of explaining policy choices.

In identifying the societal actors and the characteristics of their situation in the international economy likely to affect their policy preferences, Gourevitch (1986) also summarizes and categorizes the vast field of literature in social science linking policy outcomes to politics into five explanations: production profile, intermediate associations, state structure, economic ideology, and international system. Among these explanations, the state structure explanation relies on the logic that as societal forces and representative associations must act through the state to attain policy goals, the structure of the state, its rules and its institutions have a very substantial effect on policy outcomes. On one hand, Gourevitch accredits the power of the state structure explanation, as decision-making mechanisms have an effect on the actual outcome of the aggregation of societal preferences and lobbying of interest groups and parties; but on the other hand, he also takes note that its explanatory power is weakened by context depending on the

circumstances of the actors, the rules, the bureaucracies, and the changing preferences resources of over time.<sup>43</sup> Instead of developing the state structure explanation further, Gourevitch's work focuses more on the impact of international crises upon domestic policy.

Meanwhile, the seminal work by Douglas C. North makes the state structure-based, institutional explanation very powerful in the context of domestic and foreign economic policymaking. North, a prominent economic historian and Nobel laureate, has clarified the relationship between policymaking and policy output in a series of book volumes. In volume coauthored with Robert Paul Thomas, North emphasized institutions as the determinant of economic performance, and relative price changes the source of institutional change.<sup>44</sup> In his subsequent research, he examined the structure of economic systems and outlined an economic theory of the state and ideologies that support the modes of economic organization, and explored dynamic forces that force institutions to adapt to survive.<sup>45</sup> A decade later, in his book, 'Institutions, Institutional Change and Economic Performance', he highlighted the importance of institutions that can be ignored in economic analysis as they play no independent role in economic performance, and emphasized that institutions are designed to achieve efficient outcomes.<sup>46</sup> In other words, according to North, economic performance depends heavily on institutions. It is the capacity of the institutions that lead to different policy choices, which vary by levels of strategic decision-making. Bureaucratic capacity is the key factor that leads us to the

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<sup>43</sup> Gourevitch, 1986.

<sup>44</sup> North and Thomas, 1973.

<sup>45</sup> North, 1981.

<sup>46</sup> North, 1990.

institutional variances shown in East Asian economies. The ideological representation or regime type, embodied by each of the states alone, cannot explain the variance of policy choices.

### *Coalitions*

A successful policy implementation process requires the different actors – political parties, interest groups, and at times, bureaucratic institutions – to resolve their political differences. Reconciling or compromising in the interest of a policy outcome is not a simple task when it comes to foreign economic policymaking. The issue at stake presents potential consequences that vary largely amongst the domestic entities that are to be affected. Such interactions amongst political actors could be resolved via political lobbying, proposing or enacting legislations, or selecting a leader via elections. At the ministerial level, organizational conflict may arise via power struggles in a state's budgeting, diplomatic agenda setting, mobilizing domestic interests, and conveyance of the public opinion to the executive level.

Many political scientists have grappled with building a framework that explains the dynamics of coalitions and political survival amongst actors, using qualitative methods or formal modeling. Bueno de Mesquita et al (2003) shows through historical analysis and formal modeling how political leaders allocate resources, and how institutions responsible for selecting leaders create incentives for those leaders to pursue certain policies; thereby presenting the political pathways toward policy prescriptions. They define the concept of the 'winning coalition' as the group to which a leader provides answers to retain power, and the group that controls the essential features that constitute

political power in the system.<sup>47</sup> According to the authors, the ‘winning coalition’ in a democratic system is the group that elects the leader, and in a non-democratic system, it is the group of people that control other instruments of power to keep the leader in the office. The crux of their argument is that political leaders need to be placed in the ‘winning coalition’ to gain control of power or be in office, and that they can do so making three related sets of decisions. First, they can choose a tax rate to generate government revenue that influences labor activity; second, they can spend the revenue raised in a manner designed to help incumbency; and third, they can provide a mix of public and private goods to the people.

While Bueno de Mesquita et al (2003) provide an argument fairly adaptable to political coalitions around the globe, assessing the dynamics of political coalitions in the context of East Asian political systems requires a detailed examination of the findings of scholars working specifically on East Asia and the concept of coalitions. Gerald Curtis (1999) has covered the evolution of Japanese political parties in the 1990s, focusing on the LDP’s loss of power in 1993 and forecasting the LDP’s future in Japan as the prominent majority party. While the volatility in Japanese politics since the 2010s makes it quite difficult to analyze the dynamics of the flow of power between coalitions in Japan, Curtis’s work shows that the dynamics of various factions and personalities within the ruling LDP unravel the ways in which party politics influence policy. Meanwhile, Christina Davis (2003), in examining the interactions among politicians, agencies, and interest groups in the Japanese agricultural sector facing liberalization pressures from

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<sup>47</sup> Bueno de Mesquita et al, 2003. pp.7-8.

foreign trading partners, showed in a '2<sup>nd</sup> image reversed' way that the international context alters the balancing of interests among domestic actors. On South Korea, Youngmi Kim (2011) has argued that a weak institutionalization of the ruling party and the party-system explains political instability and inefficient governability in post-authoritarian South Korea. A comparative study conducted by Joseph Wong (2006) on the welfare politics of South Korea and Taiwan, pre- and post-authoritarian political change, found that in which the processes toward health care reform and policy choice were uncovered. In the case of China, scholars of Chinese politics have revealed that the highest level of decision making occurs at the Politburo level, divided into separate groups pertaining to a specific agenda (McGregor, 2012). Elite-level policy making within the party has been evolving over the past decades through consecutive reforms in order to prevent local officials from expanding their power (Fewsmith, 2013). While political reforms have been playing a role in changing the political landscape of Chinese politics, it is still the case that leading members of the Politburo make the final decisions on critical issues regarding the status of the economy, especially on matters regarding trade and finance (Shih, 2009). It is for certain that political coalitions are not formed in a uniform matter across the three countries of Japan, South Korea, and China, and thus it is only natural that there is variance in which the winning coalition is fragmented under varying circumstances.

### *Agenda Setting*

Agenda setting for political institutions vary across political regimes by various political actors and agencies. In comparative politics, political regimes have been

classified mainly into presidential and parliamentary; party systems into two- and multi-party systems; and parliaments into unicameral and bicameral.<sup>48</sup> Depending on the type of government form and procedure toward agenda setting, relevant government agencies play the main role of delivering agenda for several policy areas. In a legislative agenda setting, the type of government or the processes influence the course of agenda setting a great deal. According to a large-n study conducted by Rasch and Tsebelis, there are three different ways that government shape legislative outcomes: institutional, partisan, and positional.<sup>49</sup>

For the European Union, supranational government agencies such as the European Commission, the Court of Justice, and the European Parliament transcending across the member states of the European Union address policy issues, which are delivered by member state delegations.<sup>50</sup> In the United States, where a Presidential System operates in coordination with the bipartisan Congress, the House and Senate members representing different states and districts sit on key committees and subcommittees in which important policy agenda is raised and carried out in order to enact legislations. The agenda-setting processes differ greatly in detail from country to country, but in each political system political agenda setting involves mobilization, balancing, and coordination of interests among actors that have a stake in the agenda. But as we will see in the cases of East Asian states, not all agendas will go through the same procedure, as the significance of the agenda also impacts who will have a larger say amongst the actors involved.

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<sup>48</sup> Lijphart and Aitkin, 1994.

<sup>49</sup> Rasch and Tsebelis, 2011.

<sup>50</sup> Pollack, 2003.

## *Policymaking Systems in East Asia*

### *Japan*

In Japan's parliamentary system a bicameral system is under operation under the National Diet. Under the '55 system, the Policy Affairs Research Council (PARC) was the center of policymaking. The LDP policy tribes in PARC, the special interests, and the bureaucracy were the iron triangles that protected vested interests in policymaking.<sup>51</sup> The real deliberations took place in the Council rather than in the Diet. After the electoral reform in 1994, the PARC was still in existence and were still active, but changes in the electoral system rendered politicians generalists rather than someone covering certain policy fields.<sup>52</sup> Japan's political system also embodies a very strong bureaucracy that may at times exert more power in actual agenda setting and implementation of policy than the parties or politicians themselves. In the actual policymaking, laws of establishment of bureaucratic agencies, career patterns of bureaucrats, and the management of information serve as critical factors that shape policy outcomes.<sup>53</sup> At the apex of U.S.-Japan economic frictions, the MOF had the upper hand than the BOJ in domestic policymaking, in addition to the political linkages it possessed; the METI found itself desperately seeking to balance its economic interests with security interests in the U.S.-Japan bilateral relationship. The MOF still plays a very prominent role in policymaking above all other government agencies in Japan, especially in matters of budget. In the U.S.-Japan disputes that culminated in the 1980s, the MOF served as the prime decision-maker.

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<sup>51</sup> Curtis, 1999.

<sup>52</sup> Krauss and Pekkanen, 2011.

<sup>53</sup> Grimes, 2001.

*South Korea*

Although South Korea is no longer an authoritarian regime, the supreme power of the Presidency can be attributed to the past practices under dictatorial presidencies. While it is basically a Presidential, multi-party democratic system, South Korea's political sphere is run mainly by the conservative party and the progressive party, both of which have been changing names continuously in the past decades in the postwar period. While the bureaucratic system very much resembles that of the Japanese bureaucratic system, with the MOSF acting as the principal agency for budgetary issues that are largely linked with the economy, when it comes to agenda setting and policy guidelines, it often finds itself delivering the interests of the incumbent party and the Presidency. The peculiar security conditions of South Korea influences politics a great deal, if not the economy so much as of late. As the Korean peninsula had been the battlefield of the contest of ideologies – communism and democracy – South Korea's transition into a democracy and high-paced economic growth was accompanied with endless tug of wars in political agenda setting and campaigns by political leaders. Because the presidential election occurs every five years without re-elections, and political parties seeking incumbency are geared towards agenda setting to capture the minds of voters largely depending on the political and economic climate, it is often the case that long-term policy goals in security and economic issues are sacrificed at the expense of political winning, and promises are unfulfilled. The overhaul of the presidential cabinet at each presidential inauguration also leads to incoherent directions and inefficiencies in agenda setting and policy implementation in concerned policy areas of taxation, defense, education, and welfare.

### *China*

In China's authoritarian political system, the policy decision-making process is clearly different from those of Japan's and South Korea's. Ministries compete to gain their interests, but because the real power derives from the small number of politicians in the Politburo, the bureaucracy or the military mainly plays the role of the agent of the principal, which is the top leadership of the Chinese Communist Party. Over the past decades since Deng's economic reform, there has been a rise of the preponderant role of the leadership (领导: *lǐngdǎo*) and collectivized decision making process with checks and balance, presenting greater authority for the top leaders in foreign affairs at the expense of the Ministry of Foreign Affairs.<sup>54</sup> In matters pertaining to economic issues of trade and finance, it is the Leading Group of Economic and Financial Affairs deciding on important issues of the Chinese economy, and the ministries are dependent on the power that trickles down from vice premiers in economic and financial affairs that have close linkages to the specific industry or ministry. The fact that Chinese vice premiers serve as the head of negotiations for foreign economic policymaking (i.e., S&ED) rather than ministers of finance also prove that the Chinese leadership exercises its policy influence via people in the Politburo. Also, it is important to note that the People's Bank of China, which is the Central Bank, has seen its policy influence expand over the past two decades, but still acts as an agent of the Chinese leadership in policy implementation or delivery of changes to the Chinese economy.

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<sup>54</sup> Lu, Ning. 1997. Lu writes that while the People's Liberation Army, or the Chinese military, is a significant actor in the political system, it has not become an independent force in foreign policy decision-making and remains under the control of CCP leadership guidelines.

## **Political Systems: Postwar Government Types and Political Leadership**

### ***Japan***

#### *Parliamentary Representative Democratic Monarchy under One-Party Dominance*

Japan's political system throughout its years in conflict with the United States in terms of trade and finance can be best characterized as the Liberal Democratic Party of Japan (LDP)'s one party dominance. Japan in the postwar period has maintained its monarchy for symbolic purposes, which was also a consensus with the U.S. government's intent to retain the monarchy for several reasons during the SCAP period from 1945 to 1952 (i.e., political stability, gaining public support and acknowledgement for the American presence). Allied occupation persisted until the Treaty of San Francisco on April 28, 1952. Since the establishment of the Katayama Cabinet in 1947, the Japanese political system was in flux with various competing political parties until the year 1955 (the starting year of the Ishibashi Cabinet), the year in which the one-party dominance of the Liberal Democratic Party began and lasted until 1993.<sup>55</sup> The Yoshida Doctrine compelled the system to keep a very low profile on diplomacy or security, and focused primarily on the goals of economic development. After the Americans left, Japan continued to focus on these goals under subsequent prime ministers of the LDP. The LDP's consistent rule in power created both pros and cons in the process of development of the Japanese political economy: on one hand, it provided political stability for focus on the economic aims and targets to be reached, but it also became the profound roots of rigidity and political mannerisms that became very difficult to amend over time.

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<sup>55</sup> Ishikawa, 1995.

The 1955 system lasted throughout the years of U.S.-Japan trade and currency conflict from the 1960s to the 1990s. Because the MOF entry-level recruitment of career track officials (there are also non-career track officials who have different paths of promotions within the MOF), its entering bureaucrats are largely young Japanese males fresh out of the University of Tokyo excelling in the fields of law or economics and finance who have also developed bonds and networks with their university seniors, juniors, or cohorts. These relationships are a key source of human interactions as they climb the ladder. Many continue to pursue the career path of a MOF official, but some decide to voluntarily drop out of the line of promotion in order to join politics or to study abroad.<sup>56</sup> The close linkages between the MOF as one of the most powerful government entities of Japan are proven by the ascendancy of MOF high-ranking officials to political seats in the Diet.<sup>57</sup> The linkages between the MOF and the political world were made largely possible due to the common practices borne out of numerous factions and their sustainability over the years, as the 1955 system matured into a consolidated format. The ongoing traditions, or practice of securing post-retirement jobs for MOF officials (*amakudaris*) also facilitates the MOF OB (old boys) to be active within the realm of

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<sup>56</sup> This has become more apparent amongst younger generation officials of our time who find the work at MOF extremely demanding. Night shifts are commonplace and the MOF even has a basement hotel for the officials to avoid high taxi costs to return home after a nightshift. Personal observations and interviews. Some of the very smart, current generation youngsters fresh out of Todai (University of Tokyo) seemed to believe that after working three to five years for the MOF, they will be able to accumulate work experience and enter the political scene with the political capital and connections accumulated within the MOF, or to study abroad with government sponsorship and financing, then choose other professions such as the academia. However, this is only a small fraction of the young officers at MOF, and most would continue on with their careers at MOF.

<sup>57</sup> Very clear examples of these are Fukuda Takeo, who served as Minister of Finance then became PM, and Miyazawa Kiichi. Noboru Takeshita was also a figure that served as Minister of Finance then became PM, but he started his career as a local elections as a politician and not as a career bureaucrat in the Ministry of Finance.

public service in Japan. Simply put, the MOF officials in large part have streamlined pathways of career building in public affairs or politics in Japan. On the other hand, the Bank of Japan (BOJ) did not possess such a tool or the ladder toward political ascendancy.<sup>58</sup> BOJ officials, most of them with degrees in economics in Japan's prestigious universities, work for the bank for most of their career and are sent abroad to study economics or topics relating to finance, and end up working for financial institutions in the private sector after retirement. While they also have network of their own, their network is not geared toward climbing the ladder toward political debut.<sup>59</sup>

The LDP, which stood for center-right conservatism, had many political factions, one of which later formed another party outside the LDP under the party name DPJ, a center-left party in 1998. The political landscape and party politics in Japan were quite different from today in the years of U.S.-Japan trade and currency conflicts in the 1970s and 1980s, as all of the ruling party was primarily the LDP. Rather than the ongoing political battles that we often witness today between LDP and DPJ or the coalitions between LDP and Komeito to gain political power, in those days, political factions within the LDP played the role of deciding the direction of party leadership of LDP, which remained strong as the major party until Miyazawa Kiichi's serving period as prime minister until August of 1993.

### ***South Korea***

#### *From Dictatorship to 'Semi-Parliamentarian' Strong Presidential System*

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<sup>58</sup> Grimes, 2001. BOJ officials' entry into electoral politics is rare, and a large portion of the BOJ *amakudaris* end up with positions in the private sector.

<sup>59</sup> Grimes, 2001. p.40.

South Korea's political system to date has been very transitional. At first glance, South Korea's political system today may largely resemble Japan's in that it is a democratic system. However, in actuality, it started from authoritarian leadership and military dictatorship, then civilian leadership since the postwar years. Top-down decisions and reckless behaviors by presidents who voted themselves into office were commonplace until the civilian government came into office in 1993. To be fair, although South Korea has achieved an enormous success in democratic movement, due to the legacies of strong presidency, South Korea's governance finds itself at times troubled and affected by the practices and remnants of yesterday in the direction of unilateral decisions.<sup>60</sup>

By building a democratic system, Japan and South Korea claim to stand for the 'separation of powers' in their governance system. One cannot deny that the years under American Occupation influenced the two countries' path toward the system of 'separation of powers.'<sup>61</sup> Despite the fundamental structural coincidences between the two countries, there are also fundamental differences in the nature of political leadership, which must be discussed as the background for a comparative analysis.

There are various differences in how 'the separation of powers' is exercised and how the political system operates in the two countries. However, one big commonality is in the process of the selection of the country's leadership – in which Japan in its general

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<sup>60</sup> This is not to state that South Korea still lives in under authoritarianism, but is only pointed out to emphasize that it is still in the process of achieving full-fledged democracy. Scholarship outside South Korea may not pinpoint on this to a great extent, because these issues are always relative and minimal compared to the state and situations in North Korea, an authoritarian regime.

<sup>61</sup> Unfortunately, some of the borderlines between the administrative, legal, and executive branches were nebulous at times of political scandals and tyrannical behavior by the legal branch (which has become quite notorious in recent decades).

elections and South Korea in its presidential elections show similarities in the intent for direct vote. Japan's case is a parliamentary system in which the House of Representatives (衆議院, *shūgiin*) recommends the candidate for the prime minister's seat, which is most likely the leader of the majority party. This was fully established under U.S. Occupation after the devastation of the Pacific War, but there has been no real political opposition to the system itself since that time.

In the South Korean case, however, direct voting was earned by paying a huge price during the years of movement toward democracy under dictatorship and military rules following the Occupation years. The peculiarities of the two Koreas divided with partial remaining constituents (although very minimal in absolute numbers) longing for a leftist regime created complications within the political system. The specific conditions of ceasefire with North Korea following the Korean War deeply affected the initial presidencies and their political behaviors just after the Occupation years. During Kim Il-sung's reign in North Korea, South Korean politics was constantly swayed by its relationship with the North.<sup>62</sup> For example, following the Occupation years, when Seungman Rhee placed himself in the first president's seat, sorting out the reactionaries

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<sup>62</sup> It still is affected largely by the conditions of the relationship, but as North Korea became fragile with the great famine from the 1990s under Kim Jong-il's rule, North Korea's threats on South Korean leaders were less life-threatening than they used to be under Kim Il-sung's rule. The reasons behind this could be seen from two aspects; internally, on the competition on economic growth between the two Koreas, as initially the North started out as relatively more affluent than the South; externally, the degrees of China's political support on North Korea has decreased over time, which weakens North Korea's hardcore stance on South Korea substantially.

was his primary goal. Many innocent citizens were killed in this process, contributing to lasting enmities between the progressive and conservative camps.<sup>63</sup>

After Seungman Rhee and Yoon Boseon came the military governments by Park Chung-hee and Chun Doo-hwan. During Park Chunghee's regime, South Korea prospered greatly and went through phases of high economic growth. The political stability deriving from his prolonged leadership gradually vanished as it turned into dictatorship as he made changes in the constitution in order to stay in power.<sup>64</sup> Much of the development planning under Park was linked to South Korea's competition with the North as planners sought to deter or prevent a systematic collapse in the event of an attack from the North. Park even pursued plans for nuclear weapons development.

Chun Doo-hwan, one of the most beloved right arms of Park Chung-hee, took the initiative to fill in the power vacuum upon Park's assassination by reinventing the military coup in his style in 1980 by suppressing the rebellions in Gwangju.<sup>65</sup> During his term in office, he sought to differentiate his rule by claiming to stabilize the state of prosperity rather than emphasizing solely on growth as Park had. With immediate concerns of day-to-day life and hunger resolved during Park's regime, Chun found his

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<sup>63</sup> Jeju Uprising (or Jeju Massacre, 제주 4·3 사건) of 1948 and Yeosu-Suncheon Rebellion (or Yeosu Incident, 여수-순천 사건) clearly manifest this point. In both of the events, U.S. military commanders played a huge role in suppressing the rebellions by the Workers Party of South Korea (Namrodang, 남로당) in order to scrape off communist ideologies in South Korea. Regardless, thousands of civilians' lives were sacrificed in the process. One interesting thing to note was that Park Chunghee, who later became president via a military coup, was indirectly involved. He did not participate in the rebellion directly, but was in charge of the military section of the Namrodang, and was eventually leniently punished by turning in the list of names of the rebels.

<sup>64</sup> Park Chunghee came into power when he succeeded in his coup-d'etat in 1961, and from 1972 until his assassination in 1979 the Yushin Constitution was adopted to consolidate and monopolize his highly centralized, authoritarian power. Yushin means "rejuvenation" or "renewal" as in the Meiji Yushin (restoration), in order to signify self-perpetuating significance of Park's authoritarian rule.

<sup>65</sup> Gwangju Uprising (or Massacre)

own strategies of keeping the public happy by deploying politics emphasizing the 3S (sports, sex, and screen). His attempt to prolong his leadership as in the days of Park's leadership went down the drain, as the public had developed a very acute awareness on political leadership and desired democracy. He handed his seat to Roh Taewoo, one of his military cohorts.<sup>66</sup> However, due to the strong public desire for democracy manifested in every riots, Roh had to go through a national election via direct voting, standing against his rivals (the 3 Kims: Kim Young-sam, Kim Dae-jung, and Kim Jong-pil) who were primarily from the democratic movement background. The failure to agree to a single candidate within the 3 Kims resulted in Roh's winning of the election.

The history of dictatorship in South Korea created the practice of imperial presidency, or omnipotent presidency in which the power of the government and the bureaucracy as a whole is centered in the presidency. While the militarist characteristics of the presidencies faded away in large part during the Chun and Roh administrations, the major personnel within the presidency was in large part military connections, and the connections between the presidency, military, and the Ministry of Defense was very strong during those years. When Roh stepped down as the last president from the military, the power that was centered in the military vanished, but the strong presidency

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<sup>66</sup> Chun and Roh were both members of the 'Group of One' (*Hanahoe*, 하나회), which was an unofficial private group established secretly by members of the 11<sup>th</sup> class of the Korean Military in 1955. Chun ruled from 1980 to 1987 and Roh from 1987 to 1993, but when Kim Young-sam came into power, the legitimacy and ruling during their times in office was put under scrutiny by Kim Young-sam and both were trialed and sentenced to death, but both were freed by special pardon (amnesty) by Kim Dae-jung when he came into office. For the next two presidencies of Roh Moo-hyun and Lee Myungbak, both Chun and Roh enjoyed their social lives with loads of money collected during their regimes. Considering the public outrage, the Park Geun-hye's administration began a prosecutor's investigation on Chun's personal funds. It is widely known that she found Chun's downgrading and labeling of her father's term in office as corruptive leadership discomforting. Park's visit to Chun's residence in 2004 was the last she had seen Chun in private capacity.

in governance and the practices of bureaucracy subservient to the presidency still remained.

Overall, the features of South Korea's political transitions and leadership changes were circling around the movement of the center of power. It also involved the amendment of the constitution, which was rewritten nine times since the establishment of the Republic of Korea in 1948.<sup>67</sup> Issues concerning the security relations with North Korea and U.S. military presence in South Korea persisted. During the days of trade and currency conflicts with the U.S. from the 1980s to the 1990s, South Korea was going through these transitions. Though the presidential system had lasted for a long time, the transitional features of the leadership from military to civilian and the remaining practice of a strong presidency has fundamentally shaped the policy formation process.

### *China*

#### *'Top-Down' Authoritarian System*

Since the establishment of the People's Republic of China by Mao Zedong after the Communist Party won the war against the Kuomintang, China has maintained a top-down authoritarian regime, in which the Politburo Standing Committee will be fully responsible for their policy actions. In the pyramid-like power structure within the party, political leaders pursue their grand agenda with ministries supporting them in the background.<sup>68</sup> Ministries follow up on the political decisions of the party. Since its establishment, the

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<sup>67</sup> Hayes, *Ibid.* Most of the early revisions of the constitution had to do with lengthening the presidency for the incumbent president to stay in power. The latter revisions are more prodemocracy oriented revisions, in which the people of South Korea have achieved their say against authoritarianism.

<sup>68</sup> Hayes, 2012. The PRC's Constitution states that ministries exist to support the works of the party. This has caused problematic issues over the years, as politics may override administrative agenda. In Mao's years, prioritizing administrative matters was subject to purging.

PRC has seen more transitions in its economy than it has in its political system. Its political and economic leaderships can be divided into roughly five periods since the 1949 establishment of the PRC; the first generation by Chairman Mao Zedong and Premier Zhou Enlai (later also Hua Guofeng); the second generation by Chairman Deng Xiaoping and Zhao Ziyang (later Li Peng); the third generation by Chairman Jiang Zemin and Premier Zhu Rongji; the fourth generation by President Hu Jintao and Premier Wen Jiabao; and the fifth generation and the incumbent, President Xi Jinping and Premier Li Keqiang.

The CCP's political leaders are composed of three major roots: the Princelings or the Crown Prince Party (*Taizidang*, 太子党), the Shanghai Clique or the Shanghai Gang (*Shanghaiifang*, 上海方), and the Populists or the Chinese Communist Youth Corps (*Gongqingtuan*, 共青团). The Princelings are descendants of former top leaders in Chinese politics, who have been trained in Chinese politics in their upbringing. One good example is Xi Jinping, son of Xi Zhongxun. Jiang Zemin had served as Shanghai Mayor prior to his presidency, and during Jiang Zemin's rule, the Shanghai Clique was a group of CCP members who rose to prominence from their bureaucratic positions in connection to the Shanghai municipal administration and Jiang's protégés. The Shanghai Clique had an informal operating group inside the party, but has been gradually losing power among the three factions as the members are aging. During Hu Jintao's leadership, China's inner party politics seemed to be constructed more or less in two coalitions: the 'elitist faction' led by Wu Bangguo and Jia Qinglin (both protégés of Jiang) and the 'populist faction' led

by Hu Jintao.<sup>69</sup> The elitist faction represented business interests of the urban areas, whereas the populist faction represented the poor migrants and laborers in the rural areas. At the moment, China's presidency is occupied by the elitist faction (Xi Jinping), while the premiership is occupied by the populist faction (Li Keqiang).

In the years under Mao's regime, China's political system inherited the Soviet Union's system, but not in the exact, identical forms. The elections held in 1953 for delegates to the First National People's Congress (NPC) and the constitution ratified in 1954 became the foundations of China's political system, in which Mao was formally elected by the Congress as Chairman of the People's Republic of China. There are two main hierarchies – the party and the government.<sup>70</sup> The memberships are interlocked, which in turn create overlaps of power within the system. China constructed a system in which the National People's Congress, which is an enormous Congress of representatives of provincial municipalities and townships from different regions of about 2000-3000 people, would delegate the power to the Standing Committee of the NPC. The NPC, also in theory, elects a Central Committee of voting and non-voting members, and these members in theory choose the members of the Politburo Standing Committee, which will direct the Standing Committee of the NPC. Elections within the party are basically in theoretical terms, as in many prior cases, it has been the incumbent party leadership that implicitly designates the succeeding leadership.

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<sup>69</sup> Cheng Li, 'The Powerful Factions Among China's Rulers', BBC News, November 5, 2012. LI notes that the elitist faction excels in banking and economic policy formation, whereas the populist faction is experienced in rural administration. <http://www.brookings.edu/research/articles/2012/11/05-china-leaders-li>

<sup>70</sup> Dreyer, 2010.

Within the party hierarchy, the Politburo Standing Committee has overriding priorities in all parts of the system in the country – the state, the economy, the civil service, the military, police, education, social organization, and the media.<sup>71</sup> In terms of administrative affairs, the State Council is in charge of delegating affairs to the ministries. In other words, the ministries are a reflection of the State Council's motives in implementing policy.<sup>72</sup>

China's central ministries recruit their officials from a huge number of applicants who aspire to climb the bureaucratic ladder. Many graduates fresh out of China's top ranking universities – Peking University and Tsinghua University – try out for the civil service examinations, as do many in Japan and South Korea. Probability-wise, it is extremely competitive to gain a seat.<sup>73</sup> For a ministry official, supporting the guidelines of the leadership would lead to seizing opportunities in climbing the ladder in politics. Officials are bound to have both ministerial and personal incentives, but public service jobs do not guarantee an ample salary, and in the process of climbing the ladder, many officials fall

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<sup>71</sup> McGregor, 2010. pp.18-19.

<sup>72</sup> Dreyer, 2010. pp.89-94. The Chinese political system may appear quite complex compared to other western democratic party systems and other countries' systems largely affected by western influence like Japan and South Korea. Dreyer also notes that westerners are most often surprised by how the top leaders simultaneously are in control of several organizations that possess power, as in many western countries, political systems are structured in a way that different organizations would vie for political power.

<sup>73</sup> Personal observations and interviews with students at Peking University and Tsinghua University. While gaining admission to these top-ranking universities must also have been a severe competition in the *gaokao* (高考), students toward the end of their college years throw themselves into another competition for public service examinations. Students' number-wise, the competitions for the number of entry-level public service jobs available in the main ministries of China are far severe than competitions in Japan and South Korea.

into the temptations of corruption.<sup>74</sup> Factional conflicts also exist within this top-down system, which in turn complicates the process toward the outcome of policy.

To this day, the Chinese people regard Chairman Mao's achievements greatly, for he has unified contemporary China. However, whereas Mao may have had success in consolidating his power in the political system, the system that he created, while superficially geared towards egalitarianism, in reality caused people to seek measures of personal connections (*guanxi*) outside the system to get ahead. Corruption has become commonplace. Mao also did not possess the skills of an economic planner, and many of his economic plans in his ideas of taking the country forward ended in failure (the Hundred Flowers Movement, the Great Leap Forward, the Socialist Education and the Cultural Revolution). Because Mao failed to establish economic goals toward the end of his term, Deng's return to power in the post-Mao era embodied a strong emphasis on reestablishing economic goals. Eventually, Deng's leadership paved the way toward China's economic opening.

**Table 2-1. Political System Structures in Japan, South Korea, and China**

	<b>Japan</b>	<b>South Korea</b>	<b>China</b>
Political System in the Postwar Years (1945-present)	Parliamentary Representative Democratic Monarchy under One-Party Dominance	Transitional system from Dictatorship to 'Semi-Parliamentarian' Strong Presidential System	'Top-Down' Quasi-Authoritarian System under One-Party rule (The Chinese Communist Party)
Executive (Administrative) Branch	Prime Minister Cabinet – heads of national ministries	President (5 year term) Prime Minister Three Deputy PMs Cabinet (State Council) – heads of national ministries -Board of Audit and Inspection	The State Council -Premier -Vice Premier -Heads of national ministries and commissions -Audit Agency
Legislative Branch	National Diet Elections and Proportional Representations -House of Councillors (3 year terms)	National Assembly Elections and Proportional Representations (Unicameral, 4 year terms) Committees	National People's Congress The Politburo Standing Committee -Local Elections

<sup>74</sup> This has become more prevalent during the Hu Jintao-Wen Jiabao years. The new president, Xi Jinping, has declared a war on government official corruptions and the use of luxurious goods by bureaucrats, and has been seeking to implement cost-saving policies in the public service arena.

	-House of Representatives (4 year terms) Committees		
Judicial Branch	Constitution Supreme Court (最高裁) (Chief and 14 additional Judges, appointed by the Cabinet from the list provided by the Court) The Court is the "Grand Bench" (大 法廷 <i>Daihōtei</i> ), subdivided into three "Petty Benches" (小法廷 <i>Shōhōtei</i> ) of five justices each	Constitution Supreme Court (Chief and 13 additional Justices, 6 year terms) Constitutional Court Lesser Courts (9 justices, 3 each appointed by the president, the National Assembly and the Chief Justice)	Supreme Court High People's Court Intermediate People's Court Basic People's Court
Political Parties	1. Liberal Democratic Party (majority) 2. Democratic Party of Japan (minority) 3. Komeito 4. Yushinnokai	1. Saenuridang (incumbent, majority) 2. Minjudang (minority)	The Chinese Communist Party (Other parties suppressed by the CCP)
Bureaucracy	Constitution before the PM, but bureaucracy is highly influential, often times overriding political decisions	Constitution before Presidential Power Bureaucracy subordinate to Presidential Power	Constitution serves for the party Government institutions are designed to serve the Communist Party

*Source: Compiled by author based on readings on Hayes (2012) and respective government agency websites*

### **The Logic of Policy Formation in Japan, South Korea, and China**

Political capacity in the three countries with regard to policy-making process is vividly manifested in the ways the ministries of economic and financial policies function. Often times, one can easily witness which institution possesses the upper hand in economic and/or financial policy formation by analyzing the interactions between central banks, ministries of finance, ministries of commerce or industries, ministries of foreign affairs, and the political parties and leaders involved. In responding to foreign pressures on trade and finance, a firm agenda is necessary for defending cases with logical arguments. In the absence of such an agenda, a successful defense cannot be made, or even in the presence of a clear agenda, difficulties may arise in the execution of the agenda due to organizational conflict of interests. Who drives and executes the agenda in this process largely influences the direction of policy and the outcomes.

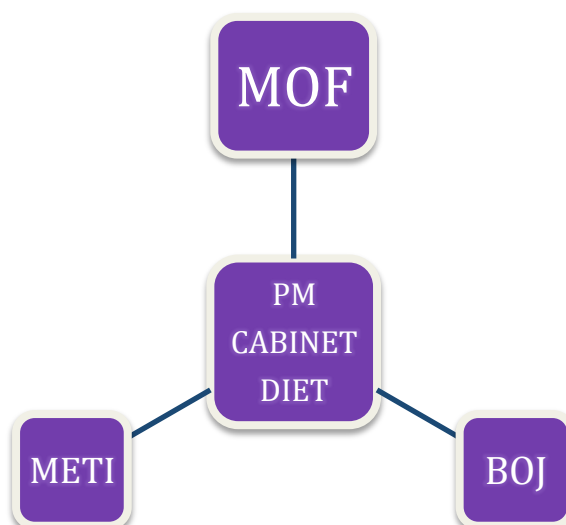
## **Japan**

### *Bureaucratic Performance*

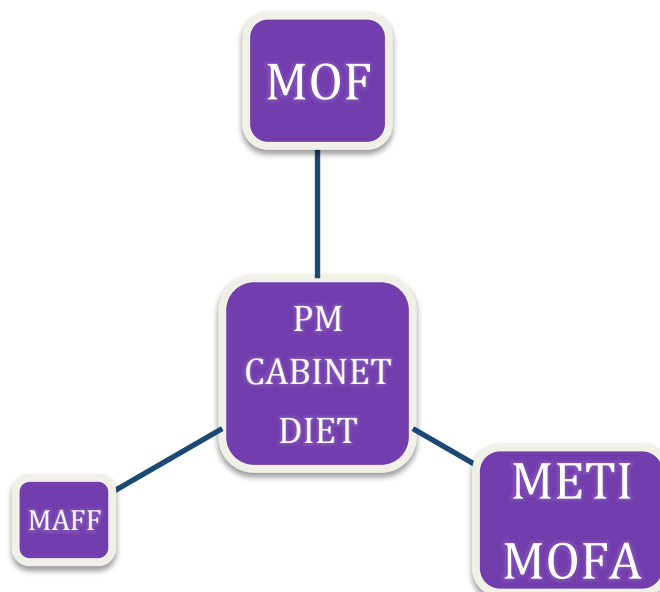
Amongst all industrialized nations, Japan is very well known for its strong and solid bureaucracy comprised of dedicated, loyal technocrats. While bureaucratic flexibility could be called into question, the high efficiency and drive of ordinary bureaucratic officials of the system in the rebuilding of Japan were clearly one of the biggest contributing factors to establishing the Japanese economy. With regard to the organizational interest conflicts that have occurred in the postwar years, the effects of capital liberalization and the Plaza Accord, the revision of the Bank of Japan law which gave more autonomy to the BOJ in 1998, and bureaucratic reforms by Koizumi could be regarded as the major events that caused Japan's biggest changes in bureaucracy. The most salient example of bureaucratic change was manifested in the budget-making process in Japan. As Koizumi undertook major reforms in the bureaucracy, setting and approving the budget would be different before, while, and after Koizumi took office. In budgeting, while the MOF served a critical role before Koizumi, during his term the executive was strengthened via the establishment of Council on Economic and Fiscal Policy (CEFP), which became responsible for overseeing budget and economic policy in 2001 for Koizumi to pursue his agenda against opposition from his own party. After Koizumi and three other subsequent LDP prime ministers whose leaderships did not last very long, the DPJ came in and established the Government Revitalization Unit (GRU) for specific budget requests and the National Policy Unit to guide economic and fiscal policy, replacing the CEFP. During the two budgeting process reforms, transparency was

increased, and the MOF experienced a modest decline and regain of its power in Japanese bureaucracy.<sup>75</sup>

**Figure 2-3. Japan's Macroeconomic Formation Structure**



**Figure 2-4. Japan's Trade and Foreign Economic Policy Formation Structure**



*Note: Without an exception, the three Japanese ministries under the Cabinet participate in a trade negotiation. However, there are different levels of policy strengths and stances by the ministries, in which*

<sup>75</sup> Park, Gene. 2010. "The Politics of Budgeting in Japan: How Much Do Institutions Matter?" *Asian Survey*. 50 (5): 965-989.

*MAFF has a narrow constituency in a declining agricultural sector, the MOFA seeks to keep pace with the global trend of trade policies, and the METI pushes for a wide range of Japan's highly competitive industries. Unlike the South Korean Presidency or the Chinese President and Premier, the Japanese Prime Minister lacks the power to push for the policy drive on his own.*

**Table 2-2. Japan's Postwar Political and Bureaucratic Transitions**

<i>Leadership</i>	<b>Prime Minister</b>	<b>Political Party</b>	<b>MOF</b>	<b>BOJ</b>	<b>METI</b>	<b>MOFA</b>				
Allied Occupation until the Treaty of San Francisco on 28 April 1952	US Occupation Tetsu Katayama (1947-48)	<i>JSP Nihon Shakaiō</i>		Established under the Bank of Japan Act (promulgated in June 1882) Reorganized under the Bank of Japan Act (1942) Amendments (1949) to establish the BOJ Policy Board		<i>Established under the 1947 Constitution</i>				
	Hitoshi Ashida (1948)	<i>DP Minshutō</i>								
	Shigeru Yoshida (1948-1954)	<i>DLP Minshu Jiyūtō</i>								
	Ichirō Hatoyama (1954-1956)	<i>JDP Nihon Minshutō LDP Jimintō</i>								
1955 System	Tanzan Ishibashi (1956-1957)	<i>LDP Jimintō</i>		The Act of 1942 was revised completely in June 1997 under the two principles of "independence" and "transparency."  The revised act (the Act) came into effect on April 1, 1998.	<i>In 1979 MITI lost its primary instrument of control over Japanese firms — allocation of foreign currency. MITI lost some influence when the switch was made to a floating exchange rate between the United States dollar and yen in 1971.</i>					
	Nobusuke Kishi(1957-1960) Hayato Kishi (1960-1964) Eisaku Satō (1964-1972) Kakuei Tanaka (1972-1974) Takeo Miki (1974-1976) Takeo Fukuda (1976-1978) Masayoshi Ōhira (1978-1980) Zenkō Suzuki (1980-1982) Yasuhiro Nakasone (1982-1987) Noboru Takeshita (1987-1989) Sōsuke Uno (1989) Toshiki Kaifu (1989-1991) Kiichi Miyazawa (1991-1993)		<i>Lost power over banking supervision to the FSA Lost control over monetary policy to the BOJ</i>							
	Morihiro Hosokawa (1993-1994)	<i>JNP Nihon Shintō</i>								
	Tsutomu Hata (1994)	<i>JRP Shinseitō</i>								
	Tomiichi Murayama (1994-1996)	<i>JSP Nihon Shakaiō</i>								
	Ryutaro Hashimoto (1996-1998) Keizō Obuchi (1998-2000) Yoshiro Mori (2000-01)	<i>LDP Jimintō</i>								
	Junichiro Koizumi (2001-2006)						<i>Renamed</i>		<i>Renamed</i>	<i>EPA bureau established (2004)</i>
	Shinzō Abe (2006-2007)									
	Yasuo Fukuda (2007-2008)									
	Tarō Asō (2008-2009)									
Yukio Hatoyama (2009-2010)	<i>DPJ Minshutō</i>			<i>Adopts consumption tax legislation</i>						
Naoto Kan (2010-2011)										
Yoshihiko Noda (2011-2012)										
Shinzō Abe (2012-present)	<i>LDP Jimintō</i>									

*Source: Compiled by author with references to the official homepages of Japanese government ministries and the Bank of Japan*

*Ministry of Economy, Trade, and Industry (METI)*

In the course of postwar reconstruction of Japan, the role of the Ministry of International Trade and Industry (formerly 通商産業省, *Tsūshō-sangyō-shō* or MITI; now the Ministry of Economy, Trade, and Industry or METI, renamed in the 2001 Central Government Reform, 経済産業省, *Keizai-sangyō-shō*) has spearheaded the country's efforts towards industrialization and acted as a critical player in establishing its foreign trade policy. Established in 1949, the MITI served as the architect of Japanese industrial policy and planning, acting as one of the most powerful government agencies in postwar Japan. It was also responsible for keeping the Japanese yen fairly low in order to maintain comparative prices for exports, and it lost some influence on policy when the yen was appreciated as a result of the Plaza Accord. Nevertheless, the METI still possesses decision-making powers on domestic industrial issues as well as trade negotiations and disputes at the international level. The drive for the METI has not changed – it is still on strengthening the industrial capacity and base of the country.

In the 1980s and 1990s, Japan succumbed to continuous foreign pressures of liberalization, and the MITI was then responsible for aiding foreign companies establish branches within Japan. As Japan progressed further into the integrated global trade framework, there have been gradual shifts in its policy direction in parallel with the shift of global policy trends and Japan's competitiveness, in which some trends were witnessed in its trade policy. The first noticeable trend is Japan's relatively increasing

degree of litigious behavior in its trade policymaking.<sup>76</sup> During the GATT years, Japan's activities and activities in trade disputes were largely in the position of a defendant rather than complainant, whereas during the WTO years, its activities as a third party participant has increased exponentially.

While traditionally Japan has been regarded a society in which litigation is not the preferred method to resolve disputes, the rigorous activities in trade disputes by Japan's trading partners (especially the United States) under the WTO regime and Japan's need to protect certain industries have prompted Japan to eagerly participate. Although its cases as complainant are still quite minimal, the widespread understanding in Japanese ministries is that litigation is not necessarily a bad thing in the age of globalization. With a trade remedy bureau established within (China has a similar bureau with the same functions that are much more pursuant of disputes, but South Korea and Taiwan have external institutions for trade remedy), METI has been acting as the main arbiter of domestic industrial and trade policy. The Trade Remedy Bureau established under METI also provides legal counseling for domestic industries free of charge up to the initiation of dispute stage, but lawsuits are pursued at the industries' own expenses.<sup>77</sup> Given the changing environment and perception toward trade litigation in Japan, the ministerial

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<sup>76</sup> Pekkanen, 2006. pp. 18-19.

<sup>77</sup> Pekkanen notes that while Japan's METI has a trade remedy bureau established under its jurisdictions, other WTO members including South Korea and Taiwan tend to have independent bodies for safeguard investigations (Pekkanen, 2006, p.148). While it is true that Japan has an inside trade remedy bureau within the METI (China has one also established under the Ministry of Commerce), strictly speaking, South Korea and Taiwan's trade remedy institutions are not completely independent and are placed under their home ministries. South Korea has the Korea Trade Commission established under the MOTIE and Taiwan has the International Trade Commission established under the Ministry of Economic Affairs.

support toward pursuit of trade remedy or disputes at the international level still remains relatively minimal in comparison to its neighboring South Korea or China.

*Ministry of Finance (MOF)*

In the area of fiscal policy and planning, the Ministry of Finance (formerly 大藏省、Ōkura-shō; name change to 財務省, Zaimu-shō in 2001, but the English name remains unchanged) is by far the most influential player in Japanese bureaucracy. The MOF has possessed the tools for yearly budget planning and taxation, and before the year 1998, it was also in charge of managing postal savings and national property, enforcement of tariffs and quotas, and regulations governing every aspect of the financial markets of Japan.<sup>78</sup> During the years of foreign pressures (*gaiatsu*) in the 1980s and 1990s, the MOF was a major contributor to formulating policies in response to foreign entities. Most importantly, it was in charge of channeling on currency and liberalization issues in negotiation with the U.S. Department of Treasury.

The MOF did lose its power in banking supervision to the Financial Services Agency and its role in financial policymaking and implementation in the passing of the new Bank of Japan law in the Japanese Diet in 1998, but with its long tradition and strong linkages to the political sphere, it still remains a prominent agency of all ministries in the Japanese bureaucracy. To be fair, since the burst of the bubble economy, Japan saw many private firms and banking institutions with the issues of non-performing loans (NPLs), and there were also political scandals involving the MOF in terms of its bureaucratic performance. Against these backdrops, in 1998, there were two financial institutions that were

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<sup>78</sup> Grimes, 2001. p.18

delegated some functions regarding the MOF's mandates in the financial markets - the Financial Supervision Agency (金融監督庁) or Financial Services Agency (FSA, 金融庁) to be short; the Financial Reconstruction Commission, which was merged into the FSA in 2001.<sup>79</sup> The birth of these institutions meant that implementing financial regulations of the private sector would be delegated to the new institutions from the MOF – it did mean a big loss of authority for the MOF in policy making.

Again, however, despite the scraping off of some functions that the MOF had had, the addition of financial supervisory institutions overseeing the financial market did not entirely strip the MOF of the activities and the leverages in foreign economic policymaking. It still remained the channel for outside powers to communicate with the Japanese economy. The MOF has also consistently played the leading role in the realm of international finance, with its international finance bureau (国際金融局) kept inside the ministry and the minister of finance engaging in active discussions of international finance at the global level. Powerful individuals who climbed the MOF promotion ladder or previously held the position of Minister of Finance despite not being a MOF bureaucrat would still enter power politics, some becoming PMs (from the DPJ, Yoshihiko Noda and Naoto Kan). The MOF's regained influence in budgetary decision-

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<sup>79</sup> As we will learn in the South Korean case, much of the changes and buildup of new Japanese regulatory bodies in finance were occurred simultaneously in both Japan and South Korea. For the Japanese, these institutions were needed to stabilize the financial markets after the bubble economy burst. For the South Koreans, there was an immediate need of such institutions in the aftermath of the Asian Financial Crisis of 1997-98. South Korea's Financial Supervisory Agency (FSA, 금융감독원) was established in January of 1999 pursuant to legislation on the last day of the year 1997, and Japan's Financial Services Agency was also established in June 1998 pursuant to legislation earlier in the same year. During the Lee Myungbak Administration, South Korea's FSA was extended pursuant to appended legislation in February 2008, by adding a Financial Supervisory Committee to the institution, and placing foreign branches in New York, Washington, DC, London, Frankfurt, Tokyo, Hong Kong, and Beijing.

making also provides it with stronger stance in the bureaucracy. In terms of budget planning, other ministries in the Japanese bureaucracy are still subject to the MOF decisions in terms of securing their budgets. Other than the budgetary role that the MOF plays, it retains the reputation from the years in the postwar years when it provided window guidance with other relevant ministries such as the MITI, thereby facilitating the process of delivering and allocating the capital and funds needed through overseeing the process of loaning from the Bank of Japan (BOJ).

*Bank of Japan (BOJ)*

It is important to mention the BOJ's divergence from the MOF and the background as to how conflicting stances in macroeconomic policy making arose between the two. In a sense, the conflict between the MOF and the BOJ was foreseen in that both organizations have overlapping goals in the areas of macroeconomic policy making, but with some differences in each of their mandates and organizational interests. With the priorities on budgeting and financial planning that the MOF had, the MOF and the BOJ would have different opinions in framing the policies.

The fact that the BOJ is not a Cabinet ministry but would have overlapping areas in the field of macroeconomic policy-making was a clear sign for potential organizational conflicts with the MOF. Until the revision of the Bank of Japan Law in 1997, which was by far the most pivotal change in the macroeconomic policy making structure in all of Japan's postwar years, the BOJ remained very constrained in its levels of central bank independence – both in 'goal' and 'instrument' independence. It was placed under a situation in which its own interpretations of the state of economy (e.g., price stability,

economic growth, and financial sector stability) was difficult to make, and in which it did not have control in the instruments of monetary policy implementation (e.g., decision making authority on interest rates, financial market intervention, and freedom from responsibility to fund government deficits).<sup>80</sup>

The MOF had possessed and enjoyed considerable policy-making power and connections to the political world that the BOJ did not. Whereas the MOF stayed powerful and closely aligned with politicians with the knowledge in economic and financial issues in the committees under the Japanese Diet, the BOJ has had a relatively weaker political say with regard to formation and execution of policy before 1997. The macroeconomic policy-making structure would begin with discussions between high-ranking MOF and Treasury officials, kept as a close secret within MOF, even from the Minister and the PM, then-political leaders would be brought in for a face-to-face meeting. BOJ officials would be informed afterwards.<sup>81</sup>

#### *Ministry of Foreign Affairs (MOFA)*

The Ministry of Foreign Affairs (MOFA: 外務省, *Gaimushō*) in Japan has been the main actor in engaging in trade negotiations toward several rounds of multilateral trade negotiations toward the Doha Round under the WTO framework, and the signing of free trade agreements (FTA) and economic partnership agreements (EPAs) as the Doha Round in stalemate prompted WTO member countries to seek for economic opportunities via preferential trade agreements. While Japan has been quite actively engaged in the proliferation of trade agreements, much of the policy drive behind it was to keep up with

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<sup>80</sup> Grimes, 2001. p.7-8.

<sup>81</sup> Grimes, 2001. P.128.

the global pace with good branding for Japan, which was from MOFA.<sup>82</sup> While the METI's mandates were directly linked to serving for domestic industrial interests, MOFA's position as a foreign ministry is more sensitive and delicate in that it is not only engaged in foreign economic policy making, but also in overall diplomatic matters including security and history issues. It had other important issues in parallel with foreign economic policymaking.

In this respect, while the MOFA was deeply engaged in the negotiations toward striking trade deals and establishing trade goals to keep up with the rest of the world in terms of proliferating free trade, after thorough examinations of the after-effects, it was not directly serving for the details of trade remedies as the METI was, nor was it responsible for setting policy agendas for industries (e.g., agriculture, fisheries) that would be hurt as a result of the deals as the MAFF was.<sup>83</sup> Simply put, it could spread out all its pretty cards at the negotiation table, but it was not directly involved in or responsible for cleaning up the mess afterwards. For this reason, MOFA's positions on getting on the last train for free trade agreements would often times bring about protests from Japan's agricultural industries, which has shrunk to about 1.3% of the country's GDP. To be fair, backdropped with a relatively lower trade dependency ratio in

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<sup>82</sup> MOFA is also involved in facilitating Japanese business operations in foreign countries, for better returns for the Japanese economy and country branding. However, its delicate position as a foreign ministry constrains them from resolving matters beyond their capacity. See MOFA's support of Japanese industries abroad here: [http://www.mofa.go.jp/mofaj/annai/zaigai/kigyo/ichiran\\_i.html](http://www.mofa.go.jp/mofaj/annai/zaigai/kigyo/ichiran_i.html)

<sup>83</sup> MOFA officials appear to have certain levels of criticisms toward policies by MAFF, mainly pointing out that it has not done much in policy making either to aid strengthen Japan's agricultural sectors or to actively push them into competition with foreign agricultural goods by opening the market. In a conversation I had with a former MOFA official, 'What in the world have they done (or have been doing)? (*Karerawa ittai naniwo shitanoka*)' was the strong sentence used to imply the helplessness of MAFF policies. Personal interviews with Tanaka Hitoshi, former Japan's Deputy Minister for Foreign Affairs.

comparison to its neighbors, China and South Korea, and a large domestic market, Japan's signing of preferential agreements was relatively slow-paced, and yet, alarming to the public each time by abrupt changes in the domestic market owing to change of prices or safety of goods. Japanese agricultural industries and the public protective of the Japanese domestic produce are gradually losing stance, and their voices are not as strong and aggressive as their counterparts in South Korea, in which a similar trend of marginalization in policymaking and aging of farmers is rapidly occurring. In the midst of interest divide with the agricultural industry, the MOFA still plays a vital role in paving the way for free trade in the trade negotiations, and it will continue to be so in the TPP negotiations as well, since Japan has agreed to participate in the negotiations.

*MAFF (Ministry of Agriculture, Forestry, and Fisheries)*

As the agricultural industries in Japan has declined considerably in the postwar years, the power of the Ministry of Agriculture, Fisheries, and Forestry (MAFF, 農林水産省, *Nōrinsuisanshō*) has also decreased in parallel with the power transition. The Japanese economy no longer relies solely on its production of agricultural goods, yet, due to the traumas of food shortage crisis that the Japanese went through in the wartime, the MAFF has advocated the need for food self-sufficiency and food safety in Japan.<sup>84</sup> This policy stance has been strongly supported by agricultural industries involved and the politicians of the diet who built their political foundations in their country towns of their origin, in

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<sup>84</sup> Based on conversations in a group meeting with Takashi Shinohara, DPJ politician, former Minister of Agriculture, Fisheries, and Forestry. Shinohara was scornful at his own party's then top leadership, Kan Naoto, for considering participation in the TPP negotiations. Fond and reminiscent of the days in which Japanese agriculture flourished in the Edo period, he was also building rare edible plants in Japan outside the ministry building. He also circulated his featured article in the Economist to demonstrate his advocacy for Japanese agriculture. [http://www.economist.com/blogs/banyan/2010/11/japans\\_farming\\_ministry](http://www.economist.com/blogs/banyan/2010/11/japans_farming_ministry)

which production of certain agricultural goods would be critical for the survival of the villages.<sup>85</sup>

However, due to the shrinking size of the Japanese farming industry and the pressures for further agricultural opening, the MAFF has been losing ground in the competitive fight with ministries in advocating for food self-sufficiency and protecting the Japanese agricultural market.<sup>86</sup> At the negotiation table, METI and MOFA have a stronger say than the MAFF, and the official documents from negotiations are also archived by the MOFA.<sup>87</sup>

## ***South Korea***

### *Bureaucratic Performance*

South Korea's fundamental structures of macroeconomic decision-making around ministries is in large part similar to Japan's, as South Korea in the postwar years

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<sup>85</sup> Kim, Hyun-chong, 2011. As the former negotiator for the Japan-South Korea FTA (later also chief architect of the KOR-US FTA), Kim notes in his memoir that In 2003, after the five years of joint study on the possible FTA, Japan suggested opening of markets for manufactured goods and agricultural goods at a very high level of openness, but South Korea was in doubt, as the Japanese Diet was full with politicians representing agricultural constituents. As the negotiation progressed, it became very clear to the South Korean negotiators that Japan was solely interested in opening the manufactured goods market at a high level, and was not very responsive with regard to opening up its agricultural goods and fisheries market. One of the main reasons why the Japan-South Korea free trade negotiations were halted was the fact that South Korea demanded that Japan fully opens its agricultural market in its entirety, and Japan simply could not accept this request.

<sup>86</sup> Mulgan, 1997. MAFF has also been battling not only against the ministries but also against domestic pressure (*naiatsu*) for agricultural liberalization that emerged from the Federation of Economic Organizations in Japan, better known as *Keidanren*.

<sup>87</sup> Mulgan, *ibid*. Ironically, Mulgan writes that several government leaders sought to use *gaiatsu* for agricultural trade liberalization for a broader agricultural policy reform in Japan, and even MAFF has been accused of doing so for its own policy purposes. Mulgan mentions examples of intra-ministerial manipulation and power contest through a rumored anecdote from the early 1980s that the MOFA had briefed the American side what to say to Japanese farm politicians during their U.S. visit on the beef and citrus liberalization issue, and another in 1982 in which a letter by former USTR William Brock to the MITI, EPA, and MOF had been suspected of being first drafted by a pro-liberalization government official in MITI.

duplicated Japan's financial system a great deal amongst all Asian nations.<sup>88</sup> However, the central decision-making power derives from the presidency. This is a big distinction from the Japanese bureaucratic system – whereas the Japanese PM does not possess the power to decide on a policy direction in the event of conflict of interests amongst the cabinet ministries, the South Korean President can have the final say on policy matters when its ministries stand divided.<sup>89</sup> This creates a lot of policy space and flexibility in comparison to the Japanese system, but there are also big downsides to this system including policy errors, abrupt changes in policy, and lack of communication with the general public regarding intent of policymaking prior to legislation and implementation of policy.

The biggest issue in the South Korean policy making system is that the strong emphasis on the presidential intent and direction of policy is by practice and one of the remnants of the dictatorial regimes. In this respect, the South Korean democracy is still a democracy undergoing the process of consolidation. Many economic and financial policy decisions were directed or at least hinted by an incumbent president, and this was more the case during the initial civilian governments of Kim Youngsam and Kim Daejung periods – transitional phases from military to democratic regimes in which political power deriving from the military forces and leadership were essentially wiped out. Also, at a glance, government procedures are conducted in a fast-paced manner to increase efficiency, but the problem is that step-by-step, methodical and careful examinations of

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<sup>88</sup> With Park Chung hee and his background in the Japanese Military Academy, many of his associates and economic policy makers of his time were trained in Japan. As overseas training became available for the bureaucrats, many technocrats now have their higher educational backgrounds in the United States.

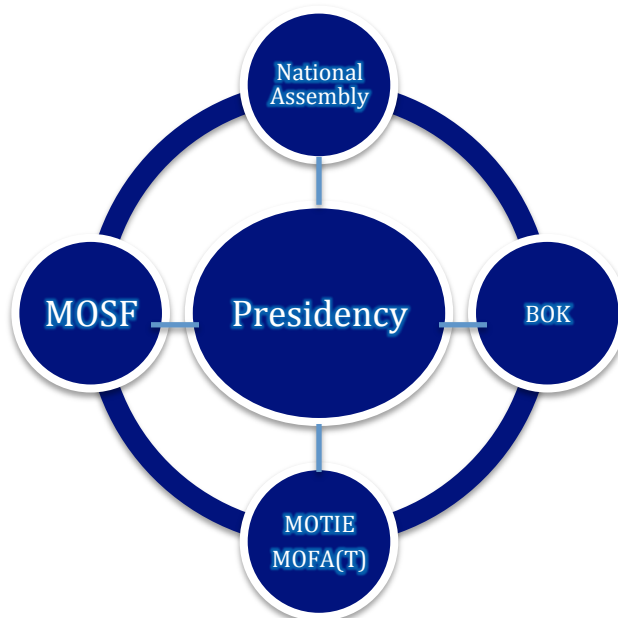
<sup>89</sup> Kim, *ibid.*

the effects of policy and the reviews of the responses of the public are sometimes sacrificed or ignored for the sake of rapidity and efficiency in achieving bureaucratic goals. In addition to these issues, the traditionally strong linkages of government-business relations embody corruption, and the practices of accepting bribery by former presidents and former high-ranked officials, which headline national news each time a prosecution begins under a new presidency. Often times, it is labeled as ‘political backstabbing’ in the media and among the public.

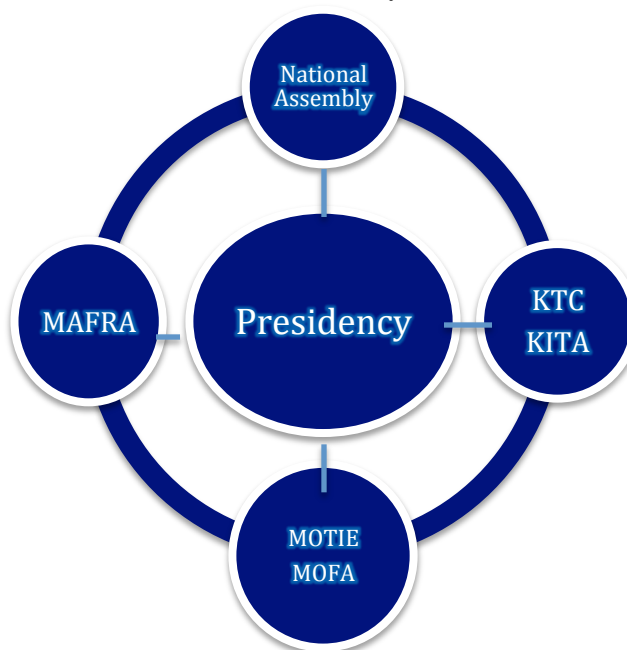
The South Korean policymaking process is very sensitive to the general public during the periods toward presidential election, because it relies on direct voting. However, ordinarily, in the processes of legislation, the South Korean ministries are authorized with the policy tools to propose and implement, but in the cases of delicate policy proposals facing debates and potential clashes of opinions in the general public and the industries, the ministries stay closely aligned with politicians in the National Assembly through committees that are led by them, thereby prompting them to announce the proposals through the media. The practice of policy coordination that occurs behind closed doors amongst high-level ministry officials (especially MOSF) and national assemblymen is not very welcomed by the public nor the media in South Korea.

The fact that South Korea experienced several transitions in the political regimes also has affected the ways in which policies would be formulated and implemented. South Korean political parties went through an overhaul following each presidential election, and name changes of political parties, factions, government ministries, and the shifting of bureaus at each administration setup were commonplace.

**Figure 2-5. South Korea's Macroeconomic Policy Formation Structure**



**Figure 2-6. South Korea's Trade Policy Formation Structure**



*Source: By author*

While it is indeed the norm that at the beginning of each administration, the reshuffling of the core policy makers is more than expected, this inconsistency would

later cause turmoil at times of economic crises, and ultimately decrease the level of efficacy in policymaking. The years escalating to the Asian Financial Crisis, and the years of recovery after the crisis serve as testimonies to the repercussions of South Korea's bureaucratic deficiencies that often times arise from inconsistency.

**Table 2-3. South Korea's Postwar Political and Bureaucratic Transitions**

Republic according to constitution revisions	Political Regime Type	Presidency/ Administration	Political Party	MOSF		BOK	MOTIE	MOFA (T)
1948		U.S. Occupation		재무부 (財務部, Ministry of Finance)	기획처 (企劃處, Ministry of Planning)	BOK Law (1950)	상공부 (商工部, Ministry of Commerce and Industry)	외무부 (外務部, Ministry of Foreign Affairs)
1 <sup>st</sup> Republic	Parliamentary System (1952-1960)	and Rhee Seungman (이승만)						
2 <sup>nd</sup> Republic	Transitional Cabinet/ Bicameral System	Jang Myun (장면)			경제기획원 (經濟企劃院, Economic Planning Board) (1961)			
	Civilian Government	Yun Boseon (윤보선)						
3 <sup>rd</sup> Republic	Military Coup Presidential System (1962-1971)	Park Chunghee (박정희)	Coup			1 <sup>st</sup> Revision (1962); 2 <sup>nd</sup> Revision (1963); 3 <sup>rd</sup> Revision (1968)	상공부 (商工部, Ministry of Commerce and Industry) / 동력자원부 (動力資源部, Ministry of Energy and Resources)	외무공무원교육원 → 외교연구원 → 외교안보연구원
4 <sup>th</sup> Republic	'Yushin' Presidential System (1972-1979)					4 <sup>th</sup> Revision (1977)		
4 <sup>th</sup> Republic	Interim Government (1979-1980)	Choi Gyuha (최규하)						
5 <sup>th</sup> Republic	Military Coup Presidential System (1980-1987)	Chun Doowhan (전두환)	Coup		5 <sup>th</sup> Revision (1982)			
6 <sup>th</sup> Republic	Military Leadership Handover Presidential System (1987-1992)	Roh Taewoo (노태우)	민주정의당 민주자유당		6 <sup>th</sup> Revision (1997)			
	'Civilian Government' Presidential System (1992-1997)	Kim Youngsam (김영삼)	신한국당 한나라당	재정경제원 (財政經濟院, Ministry of Finance and Economy) (1994)		상공자원부 (商工資源部, Ministry of Commerce, Industry, and Resources) / 통상산업부 (通商産業部, Ministry of Trade and Industry)	산업자원부 (産業資源部, Ministry of Industry, Energy and Resources)	외교통상부 (外交通)
	'Government of the People' Presidential System	Kim Daejung (김대중)	새정치 국민회의 새천년	재정경제부 (財政經濟部, Ministry of Finance and Economy)	기획예산처 (企劃豫算處, Ministry of Planning and Budget)			

	(1997-2002)		민주당	Finance and Economy)	Planning and Budget)		Commerce Industry and Energy)	商, Ministry of Foreign Affairs and Trade)
	'Participatory Government' Presidential System (2002-2007)	Roh Moohyun (노무현)	새천년 민주당 열린우리당			7 <sup>th</sup> Revision (2003)		(통상교섭본부 신설)
	'Pragmatic Government' Presidential System (2008-2013)	Lee Myungback (이명박)	한나라당 새누리당	기획재정부 (企劃財政部, Ministry of Strategy and Finance) (2008 년 금융위원회에 금융정책기능 이관) 2013 년 부총리 부처로 승격		8 <sup>th</sup> Revision (2011) 9 <sup>th</sup> Revision (2012)	지식경제부 (知識經濟部, Ministry of Knowledge Economy,	
	Presidential System (2013-present)	Park Geunhye (박근혜)	새누리당				산업통상자원부(産業通商資源部, Ministry of Trade, Industry, and Energy	외교부 (外交部, Ministry of Foreign Affairs) (통상분야 이관)

*Source: Compiled by author with references to the official homepages of South Korean government ministries and the Bank of Korea. As much as South Korea has seen political transitions, ministries and their tasks have been subject moving and shifting around at upon each inauguration of a new presidential administration. This task also involves an entire overhaul of the cabinet members replaced by the President's close aides, and bureaucrats of high and low ranks alike are also reshuffled, leaving gaps in the flows of policy formation.*

### *The Omnipotent Presidency*

South Korea's macroeconomic policy directions have been traditionally largely formulated by the presidency in the postwar years. It could be simply a remnant of the authoritarian regimes in which presidents possessed strong power, but there are several factors to why the presidential power is supreme in South Korea even after the authoritarian rule. While the political landscape has changed toward building a democratic society and political regime and has established an electoral system of direct voting in the presidential elections, the structures of political interest mobilization, raising money for electoral campaigns (in which a lot of government-business attachment is involved), and voting behavior by constituencies have not changed greatly.

The omnipotence of the presidency may deserve credit with regard to policies that are with clear directions during the span of five years in office, but it has often times overridden macroeconomic policies made in good faith. The most tumultuous

manifestation of this was before and after the Asian Financial Crisis. Kim Young-sam had promised the public of economic goals that could not be realized before the crisis struck. After his term, he would blame his succeeding opponent and another progressive leader, President Kim Dae-jung, for the economic calamities that the public had to go through.

*Ministry of Strategy and Finance (MOSF) and the 'MOFia'*

The Ministry of Strategy and Finance (MOSF) has been one of the very fundamental pillars of South Korea's reconstruction and industrialization. But while the MOSF is a giant ministry overseeing all matters of macroeconomic policy planning, in the initial postwar years, two institutions – the Ministry of Finance (MOF) and the Economic Planning Board (EPB), were the nascent forms of the MOSF. The two government institutions were filled with officials of different backgrounds, who would often times have conflicting views and engage in power struggle.<sup>90</sup> The MOF has traditionally been stronger than any other ministry in economic and financial affairs through the Park

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<sup>90</sup> See memoirs by Kang Man-soo, 2005. Through the years of Park Chung-hee and Chun Doo-whan, Kim Jae-ik (金在益, 1938-1983), former Chief of Economy, was a favored top ranking bureaucrat in the implementation of macroeconomic policies. A neo-classical economist by training at Stanford, Kim served in the Blue House and pushed for several big chunks of market-oriented policy implementation (e.g., the real-name financial transaction system, OECD membership, free trade, and inflation control). Kim's practices of excluding people from the Ministry of Finance and recommending only those from the Economic Planning Board for important positions, would later create factions of economic officials labeled as 'originally from MOF, EPB, Ministry of Commerce and Industry, etc'. Upon his recommendations, Chun Doo-whan would appoint an official with an EPB background for the Minister of Finance seat. In 1982, the 'Jang Young-ja Fraud Incident' prompted the EPB to embark on a policy drive to implement real-name financial transaction system in South Korea. In pushing for this strategy, Kim filled the top positions of MOF with EPB officials. The year after, Kim along with several other ministers under Chun Doo-whan died in the Myanmar Aungmye National Cemetery Bombing allegedly planned and conducted by North Korea. However, the exclusivism amongst the ministries has been carried on and persists to this day, and has been manifested most recently in the cabinet set-ups by Lee Myung-bak and Park Geun-hye.

Chung-hee years, and such practices had given the name ‘MOFia (모피아)’, a combination of the words ‘MOF’ and ‘mafia’ to its officials.

Under Chun Doo-whan and Roh Tae-woo, the factional clashes were surfacing, and upon Kim Young-sam’s inauguration, the MOF and EPB were combined into a dinosaur-like humongous Ministry of Finance and Economy (MOFE) on December 3, 1994, but with a degrading of class from ‘부 (部)’ to ‘원 (院)’.<sup>91</sup> Kim Young-sam, blindfolded by his aides who did not sense any signs of macroeconomic instability, ordered that the MOF be combined with the EPB – two government institutions which had been in organizational conflict and competition since 1961. He then labeled it Ministry of Finance and Economy with a demotion of the institution. The disappearance of the former International Finance Bureau at MOF in the phase of ministerial combination of the MOF and EPB would later serve as a fatal factor in the Asian Financial Crisis. Personal testimonies by South Korean bureaucrats in the management of the Asian Financial Crisis reveal that it was a problematic top-down decision to strip South Korea’s ministries bare of its tools to control international capital flows.<sup>92</sup>

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<sup>91</sup> Kang, *ibid.* Kang noting Kim Young-sam as ‘YS’, states that his lobbied proposals to maintain the class of the ministry went down the drain, as YS dictated that no change would be accepted to the arrangement. The opposition party, which had then become a majority, also opposed to the proposed changes. Kang criticizes that the MOFE was an unconstitutional institution, as the degrading of the ministry rendered all of the previous 91 enforcement regulations of MOF unconstitutional. Under the Constitution of South Korea, only cabinet ministries retained the policy tools for approval regarding finance, foreign currency, security, and insurance. The 91 enforcement regulations had to be changed into orders by the Prime Minister, but after Kim Young-sam left office, the MOF staff worked through changing it back to the MOF’s own enforcement regulations.

<sup>92</sup> Kang, *ibid.* This is also a backdrop of South Korea’s recent deployment of macro-prudential levy, or capital controls in the aftermath of the Global Financial Crisis. (I will cover more on this in Chapter 6.) However, South Korea’s policy changes have been based on a global understanding, or standard of policy shifts and changes. The IMF’s reversal on capital controls was critical in pushing the MOSF toward seeking macro-prudentiality, and the adoption of Tobin Tax. I will return to this point in Chapter 6.

When Kim Dae-jung came into office, MOFE was able to regain the status as 부 (部) as in the MOF years, but this time the MOFE was divided into the MOF and the Ministry of Planning and Budget (MPB), which managed economic planning. This divided system continued throughout the Roh Moo-hyun administration, which inherited the political stances and systems from Kim Dae-jung. However, it did not persist for long – the two branches were combined once more as the Ministry of Strategy and Finance under Lee Myung-bak, a former CEO and Seoul Mayor, who had a big stake and drive in economic policy and planning. Today, the MOSF carries on its form from the Lee Myung-bak's years under Park Geun-hye, but with promotion in grading of the minister as the Vice Prime Minister.

#### *Bank of Korea (BOK)*

The Bank of Korea was born in the aftermath of the Korean War, when the officials of the Chosun Bank sought to restore the presence of a national bank following Japanese occupation. After the Korean War, adjustment in financial structure was badly needed, and thus with American advising the Bank of Korea (BOK) was established. The local currency value plunged, and in retrospect, many unexpected behaviors of the Japanese officials who fled with their assets in Korea upon the Japanese emperor's announcement of defeat. When the first Bank of Korea Law was written, advisory commission from the U.S. was involved, but the main scripters of the law were primarily from the Chosun Bank. The Chosun Bank had reserved their areas of foreign exchange, bank supervision under their own administrative body, which would enable checks and balances on

monetary policy amongst ministries.<sup>93</sup> Many had disappeared in fear that they would be prosecuted for being pro-Japanese (친일파 (親日派): *chinilpa*).

Based on this background, when Park Chung-hee came in, he stripped the main power from the Bank of Korea. From this point on, the MOF enjoyed the power that the Bank of Korea once enjoyed. Under Park Chung-hee, the BOK focused on facilitating the continued industrialization and the establishment of growth-focused financial system. While the BOK adopted realistic interest rates from September 1965, throughout Park's drive for industrialization, interest rates were kept fairly low to promote investment while keeping companies' funding costs low. Interest rates on policy lending were set lower than the general lending rate, and the burdens on financial institutions were compensated by refinancing through the BOK's rediscount system at low interest rates.<sup>94</sup>

The power struggle between the MOF (now MOSF) and the BOK has been ongoing for decades. The Bank of Korea has not been at the forefront of policymaking but has served rather as an agent of the MOF. In the 1980s, under Chun Doo-hwan and Roh Taewoo, the BOK strived to stabilize prices due to inflation following two decades of fast-paced industrialization. While the BOK's mandates and objectives at a broad range were not a big divergence from the MOF in terms of national development strategies on the growth path, the inner political dynamics reveal the cleavages in policy making and power rivalry between the two institutions.<sup>95</sup> Stemmed from the conflicts from the power restructuring of the MOF and the BOK during the industrialization era, the debates on the

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<sup>93</sup> Kang, *ibid.*

<sup>94</sup> Bank of Korea, 2000, pp.130-131.

<sup>95</sup> Kang, 2005, pp. 209-212.

Bank of Korea Law revision was not solely one for ‘central bank independence’, but more for the BOK’s strife and goals to retrieve the authority that they once possessed before Park Chunghee, and to be placed on equal grounds with the MOF in terms of policy agenda setting. The democratic movement of 1987 was strategically used as the backdrop for the BOK’s fight for independence.<sup>96</sup> Going with the tide, the BOK sought to have the public on their back to retrieve their rights, and beyond that, expand their authority across monetary policy making.<sup>97</sup> The decade-long fight between the MOF and the BOK ended with the establishment of an independent body for bank supervision placed outside the MOF and the BOK. The organizational conflict between the MOF and BOK continues on today.

The change of global political dynamics by the end of the Cold War and the U.S. pushes in spearheading free trade and globalization prompted South Korea to seek further financial deregulation and liberalization efforts throughout the 1990s. This was done under the name of Kim Young-sam’s globalization (세계화: 世界化, *segvehwa*), albeit incompletely. In the process, the BOK’s efforts in the 1990s were centered on stabilizing the economy and financial deregulation, and the diversification of financial structure.

While the Bank of Korea Law revision of 1997 is considered the biggest change in the

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<sup>96</sup> Unfortunately, the political dynamics of what happened during the BOK’s struggle for independence from the 1980s-90s are not really made up front and clear by the BOK in public documents. It clearly was a messy political fight that the BOK was engaged in, piggybacking on political populism as well. One can only read through other sources in order to figure out why the BOK fought so fiercely and desperately during that era. However, the practices of downgrading BOK officials by MOF officials in everyday tasks certainly was not appropriate – the political attacks on the MOF by the BOK during this time therefore was rooted in how the MOF treated the BOK on both organizational and personal levels.

<sup>97</sup> The contents of the debates between the MOF and the BOK are detailed in Kang’s memoir; however, much of these political debates are not found in the BOK’s official statements or published materials. In the official language, much of the statements are focused on what the BOK achieved through each of the revisions.

financial policy making structure in postwar South Korea, the backgrounds and the actual events that culminated in the revision diverge from the Japanese case of the BOJ law revision in 1997. First off, the BOJ law had not been revised multiple times, but the BOK law had. At times of each political transition, BOK law was revised to reflect the changes in the state of the economy. However, the conflict between the MOF and the BOK since 1987 which escalated to a political and emotional warfare had in fact stemmed from a) long-dated practices of MOF's oppressive behavior on the BOK and b) the BOK's desire to expand its policy interests that were without much logical backing.

*Ministry of Trade, Industry, and Economy (MOTIE)*

The MOTIE has gone through by far the most turbulent changes in its name and functions each time a new administration set in. From the early postwar years to 1977, it was functioning as the Ministry of Commerce and Industry, taking care of all matters in commerce, trade, and industrialization in the initial setup. As the industrialization progressed, the Ministry of Energy and Resources was established and functioned in parallel with the Ministry of Commerce and Industry until 1993, when Kim Young-sam's reshuffling of the ministry occurred. Both ministries were absorbed by the new Ministry of Commerce, Industry, and Resources initially in 1993, and later the Ministry of Trade and Industry in 1994. The focus on trade by MOTIE would come under Kim Dae-jung and Roh Moo-hyun, when it was named the Ministry of Commerce Industry and Energy, with combined mandates of trade, industry, technology, energy, and resources. However, trade negotiation authorities were mandated to the Ministry of Foreign Affairs and Trade (MOFAT, which is now MOFA) during those two administrations, in which the

proliferation of South Korea's free trade agreements was highly visible. Under the Lee Myung-bak's administration, the MOTIE was named the Ministry of Knowledge Economy, but had similar functions as in previous administrations. The Park Geun-hye administration assigned trade negotiation authority to the MOTIE from the MOFAT - in other words, the Ministry of Foreign Affairs no longer have a stake in trade negotiations. The bureaucratic transformation and reshuffling that has been commonplace at each administration's setup in South Korea has affected MOTIE considerably, and has continuously created complexities and inconsistency in policymaking

*KTC (Korea Trade Commission)*

The Korea Trade Commission is in charge of handling trade remedy issues of South Korea. It is comprised of members who come from various backgrounds regarding trade (technocrats from the tariffs bureau at MOSF, lawyers, economists, and KIEP, the Korea Institute of Economic Policy). Currently, it is placed under the MOTIE by the new Park administration, but it first started out as a bureau under the Ministry of Commerce in July 1987 pursuant to the Korea Foreign Trade Act. It was not until December 1993 under the Kim Young-sam administration that antidumping investigation authority was delegated to the KTC from the MOF (currently the MOSF). This structural change is also relevant to the formation of the Ministry of Finance and Economy (MOFE), severely downgrading the previous policy agenda setting powers of the MOF in matters of trade. Before Kim Young-sam, the MOF was also in charge of setting tariffs for various tradable goods across the South Korean borders, which also meant that it had considerable leverage on various sectors of the economy including trade. Since then, trade remedy issues have

never been reassigned to the MOF. Under the Lee Myung-bak administration, it was placed under the Ministry of Knowledge Economy, which is now the MOTIE. Despite having been shifted around different ministries, the KTC now functions as a full-fledged trade remedy investigation authority, which levies antidumping and countervailing duties. This is a divergence from the cases of China and Japan, in which the trade remedy bureaus are placed within Ministry of Commerce (MOC) of China and METI of Japan, respectively.

*Ministry of Foreign Affairs (MOFA)*

The MOFA of South Korea, formerly the MOFAT, had not been traditionally involved with trade policies. During the Kim Young-sam period, as trade policies were set by then the Ministry of Commerce – it was a predecessor of the MOTIE that had been divided into two, one pillar for industries and another for trade. The MOFAT has had a say in trade policy formation only from the Kim Dae-jung period, in which many joint free trade study groups were convened with South Korea's potential FTA trading partners, but its role in trade policymaking did not last long, as in 2013 the trade policy bureau has been moved back to MOTIE, leaving it with a changed name from the MOFAT to MOFA. During the trade negotiation bureau's operation within the MOFAT from 1997 to 2012, South Korea's free trade agreements, comprehensive economic partnership agreements had expanded rapidly. South Korea's annual GDP relied more heavily on trade than anything else. Today, the delegation of trade policies and trade negotiations to the MOTIE from the MOFAT upon the inauguration of Park Geun-hye, causing additional concerns due to the physical relocation of MOTIE to Sejong Municipality, a city to which

many government bureaus would be relocated to in order to decentralize government administration and to keep the Seoul area from being over populated and focused in the country.<sup>98</sup> Testimonies of officials from the MOFAT revealed their uneasiness about having to move to another ministry, and the MOTIE was reported to have dialed each of the deputy chief-level bureaucrats (*gwajang*) of each trade sections of the MOFAT in order to assure them that they would be welcomed wholeheartedly. Such an anecdote reveals how high the level of concern is during times of bureaucratic reshuffling of ministries following each presidential inauguration. There are also potentials in alternative agenda setting and carrying out policy agendas each time the reshuffling occurs.

*Ministry of Agriculture, Food, and Rural Affairs (MAFRA)*

The South Korean agricultural industry is not any different from Japan's in the trends of decline. While it has not been able to exercise a strong leverage over trade policy in the past decades, it has had participatory role in the formation of trade policy via its info-sharing role with regard to the specifics of the South Korean agricultural industry. The MAFRA carries more policy weight than Japan's MAFF does, as the South Korean agricultural sectors are more fierce and visible than Japan's against trade liberalization. The MAFRA operated a task force on the KORUS FTA under the Bureau of International Agriculture from March 2006 to June 2008.<sup>99</sup> This was under the presidential executive order of the Roh Moo-hyun administration before the Obama Administration requested

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<sup>98</sup> The idea of Sejong-shi came up from the Roh Moo-hyun administration, and acquiring the conditions of government administration and management via buildings, creating livable village towns for the officials, etc, took some years before this idea was pushed through the bills in the National Assembly. Previously, Kwachun, in the suburbs of Seoul, was home to many ministries including the MOSF, MKE, and the MOJ.

<sup>99</sup> Ministry of Agriculture, Food and Rural Affairs, Republic of Korea

re-negotiation on automobiles in 2010. The interests of the agricultural industry had to be conveyed in an official format since the initial KORUS FTA negotiations were highly centered on the import of U.S. beef amongst other agricultural goods, with questions surrounding the quality of the beef to be consumed by South Koreans.

Unlike the MAFF in Japan in which agriculture and fisheries are dealt with in the same ministry, the South Korean Ministry of Oceans and Fisheries oversees all matters regarding the fishery industry. Under Roh Moo-hyun, an FTA task force had also in operation from 2006 in preparation for the KORUS-FTA.<sup>100</sup> When Lee Myung-bak came into office, his administration established a new bureau called MIFAFF (농림수산식품부, Ministry for Food, Agriculture, Forestry and Fisheries), combining agriculture with fisheries. The Park Geun-hye administration divided it once more by reestablishing separate ministries each on fisheries (Ministry of Oceans and Fisheries) and food safety (Korea Food & Drug Administration). The common South Korean bureaucratic change of ministries is also manifested in the case of the MAFRA.

## ***China***

### *Bureaucratic Performance*

While the Chinese government has adopted ways of market socialism with Chinese characteristics, but the bureaucracy remains strictly authoritarian under a communist rule.<sup>101</sup> There are two major divergences from most western democracies in terms of bureaucracy; one is the top-down decision making drive, which derives from CCP party

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<sup>100</sup> The Presidential Executive Order No.19421 (March 29, 2006) enabled a task force of 4 specialists in the field of fisheries negotiation in the KORUS FTA.

<sup>101</sup> Confucian bureaucracy is not difficult to find in other parts of Asia; however, China's top-down political system makes the traits of Confucian bureaucracy far more apparent than in other cases.

discipline and power, transmitted through the ministries; lack of supervision for checks and balances.<sup>102</sup> It is difficult to expect efficiency in the enormous bureaucratic structure.

**Table 2-4. China's Postwar Political Transitions and Financial Reforms**

Leadership Generation	Chairman	Premier	Political Factions	Governance	Financial Reforms	PBC	NDRC	MOC
1 <sup>st</sup> Generation (1945-1969)	Mao Zedong	Zhou Enlai		Decentralization			State Planning Commission (1952) – Centrally planned economy	
2 <sup>nd</sup> Generation (1978-1984)	Deng Xiaoping	Zhao Ziyang		Decentralization	<b>1<sup>st</sup> Reform Era (1978-1992)</b> Established financial institutions (1978-1984)	Central Bank Status confirmed (1983)		
3 <sup>rd</sup> Generation (1985-2002)	Jiang Zemin	Zhu Rongji	Shanghai faction (Shanghai Clique)	Centralization Technocrats	<b>2<sup>nd</sup> Reform Era (1990s)</b> Initial Changes (1985-1996) Adjustments (1997-2005)	RMB Revaluation (1994) Zhu Rongji (1993-95) Central Bank Law (1995) Non-Devaluation Strategy (1996)	Renamed as the State Development Planning Commission (SDPC, 1998)	MOFTEC (1995)
4 <sup>th</sup> Generation (2003-2012)	Hu Jintao	Wen Jiabao	Gongqingtuan (Populist)		<b>PBC's Financial Reforms (2003-present)</b> Global Financial Crisis (2006-2010)	Zhou Xiaochuan Exchange Rate Liberalization (2005 & 2010)	Reborn as NDRC (2003) – socialist market economy Merged with the State Council Office for Restructuring the Economic System (SCORES, 2003)	MOC (2003)
5 <sup>th</sup> Generation (2013-present)	Xi Jinping	Li Keqiang	Taizidang (Princelings)					

### *Politburo Standing Committee (PSC)*

The Central Politburo Standing Committee (PSC, 中国共产党中央政治局常务委员会) is by far the most powerful decision making political committee consisting of the top leadership. Historically, though, the PSC was not strong from the beginning of the PRC's establishment. Under Mao's Cultural Revolution, the Cultural Revolutionary Group

<sup>102</sup> Due to the size of the bureaucracy and the CCP membership, this top-down system may be inevitable for China, as long as it seeks to maintain the political system that has originated from Mao's leadership.

dominated political power, and upon his death, the then new leader, Deng Xiaoping, sought to strengthen the party. In handling the 1989 Tiananmen Incident, the PSC voted to support Deng's decision by military intervention – it is well known that Zhao Ziyang, who opposed to declaring martial law, was removed from the PSC and incarcerated for life. Currently, the PSC is chosen from a 25 member Politburo, elected by the CCP Central Committee. Through the years, the membership has had varying numbers ranging from 5 to 9, and currently it consists of 7 top leaders of China including Xi Jinping and Li Keqiang. It is presumed that the members meet regularly on a weekly basis to discuss all matters relating to state affairs, and each member has a special policy area of expertise in the committee. Although professionalism is a priority, seniority and family ties are extremely important to rise to the PSC from the CCP membership.<sup>103</sup>

#### *State Council*

The PRC's State Council (国务院), which is the chief administrative authority in China, is comprised of the top leadership (Premier) and the heads of each government ministry, department and agency of the Chinese bureaucracy. The State Council is the chief administrative authority in the Chinese political system, and is led by the Premier of the PRC (currently Li Keqiang), who is the 2<sup>nd</sup> or 3<sup>rd</sup> ranking member of the PSC. The State Council meets every six months, with guidance and directions by the PBSC from its outcomes of regular weekly meetings on policy agendas. The State Council is very closely interlinked with the Chinese Communist Party (CCP), with the top State

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<sup>103</sup> Li, Cheng (Winter 2012). 'The Battle for China's Top Nine Leadership Posts', *The Washington Quarterly*, 35 (1): 131–145.

Councillors also being top leaders within the CCP.<sup>104</sup> This kind of system amalgamates China's communist party with the state. Currently, the principal officers in the State Council are Premier Li Keqiang, four vice premiers, five state councilors, a secretary general that tends to day to day affairs of the State Council, and all ministers of China's administrative branches, including MOF, MOC, MOFA, and the Governor of the PBC, Zhou Xiaochuan.

#### *Leading Group for Financial and Economic Affairs*

The Leading Group for Financial and Economic Affairs (中共中央财经领导小组 : *Zhōnggòngzhōngyāng Cáijīng Lǐngdǎo Xiǎozǔ*) is an inner group of policymakers in the Central Committee of the CCP and is a dependent group of the PSC that is in charge of leading and supervising economic work of the CCP and the State Council. It is currently lead by Xi Jinping, the Chinese President, and Chinese Premier Li Keqiang serves as deputy leader of the group. It was established by the PSC on March 17, 1980 to replace the State Commission for Economy and Finance in order to meet the demands of Deng Xiaoping's reform and opening up of the Chinese economy. The group is the main driver of China's economic and financial policies. Currently, other members include Zhang Gaoli (张高丽), Wang Yang (汪洋), and Ma Kai (马凯), who are all vice premiers; Wang Yong (王勇), Chairman of the State-owned Assets Supervision and Administration Commission (SASAC); and Zhou Xiaochuan (周小川), the PBC Governor.

#### *People's Bank of China (PBC)*

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<sup>104</sup> Under former premier Zhao Ziyang, there were attempts to separate the CCP and the State Council, the former as a policy implementing actor and the latter as an executor. Had But these initiatives were abandoned by the early 1990s with the ousting of Zhao Ziyang by Deng Xiaoping.

At a glance, the People's Bank of China (PBC, 中国人民银行) as a central bank placed under the State Council and the CCP, it may appear to be only an executor of the State Council's decisions on macroeconomic policy. It certainly is not independent from the central state leadership. However, over the years of China's economic reforms, it has gained policy authority to the level that it is not a puppet agency. In present-day reformist China, the PBC is by far the most important institution to pay attention to with regard to China's macroeconomic policy making. Under the guidance of the State Council, the PBC formulates and implements monetary policy, prevents and resolves financial risks, and safeguards financial stability.<sup>105</sup> Many emerging economies and industrialized economies alike tend to have previous history of central banks with low level of independence. The PBC was not an exception.

Established in 1948, the PBC was merely subordinate to the MOF, financing the Chinese state's decisions under the planned economy system until 1978. It was also the only bank in Mainland China – which therefore had to be in charge of both commercial and central banking.<sup>106</sup> In the 1980s, commercial banking was split into four main state-owned banks (the BOC, the ABC, the ICBC, and the CCB), and PBC was able to act solely as a central bank. Since then, the PBC has seen an expansion in its strengths of policy making via close interlocks with the party. As the CCP top leadership through its generational transitions started to focus on more liberal than conservative to the economy (this is labeled as 'hawkish' in the Monetary Policy Committee), the PBC was able to act in line with the policy shifts. It gained more policy authority with the passing of the Law

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<sup>105</sup> People's Bank of China, *People's Bank of China*, 2012.

<sup>106</sup> Bell and Feng, 2013, p.7.

of People's Bank of China by the NPC, on March 18, 1995. According to this law, the mandate of the PBC is keeping the currency value stable and maintaining economic growth are the two goals of the monetary policy.<sup>107</sup> The PBC manages three macroeconomic policy tools – interest rates, reserve requirement ratio, and open market operations. Exchange rate policy, however, cannot be set by the PBC or the State Administration of Foreign Exchange (SAFE) alone, and involves more contest and rivalry amongst other ministries.

Currently, China's monetary policy-making process is convened by the Monetary Policy Committee placed under the PBC governorship, with heads of different ministries coming to address their concerns in a meeting. While it is a consultative body rather than a decision making body, the contents of the meetings are communicated to the State Council, but do not create binding impact on the PBC's decisions.<sup>108</sup> Usually, the PBC draws up proposals for circulation to other relevant ministries under the State Council. Decisions are formally improved in executive meetings of the State Council, and upon approval, are announced and implemented at the PBC's discretion. Simply put, the PBC is engaged in the agenda setting and also implementation of China's monetary policy-making process, but it does its work based on the guidance from the decisions of top leadership. As it gathers international attention as a compass of the Chinese economy, the institution is gaining more authority in the policies they propose and implement.

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<sup>107</sup> People's Bank of China Law, 1995.

<sup>108</sup> Bell and Fung, pp.53-54.

**Table 2-5. Monetary Policy Committee (1997.7 - 2003.3)**

	1997.7	1998	1999	2000	2001	2002	2003
PBOC Gnr	Dai Xianglong						Zhou Xiaochuan
NECC	Chen Qingtai	Zhang Zhigang					
NDRC	Wang Chunzheng						
MOF	Xie Xuren	Zhang YC	Jin Liqun				
PBOC D.Gnr	Chen Yuan	Liu Mingkang		Liu Tinghuan			
PBOC D.Gnr	Shang Fulin		Xiao Gang				
SAFE	Zhou Xiaochuan	Wu Xiaoling	Li Fuxiang	Wu Xiaoling	Guo Shuqing		
NBS	Not existent				Zhu Zhixin		
CSRC	Chen Yaoxian			Zhou Xiaochuan			Shang Fulin
CIRC	Not existent			Ma Yongwei			Wu Dingfu
Banker	Liu Tinghuan (ICBC)			Wang Xuebing (CCB)	EZ.Zhang (CCB)	Shang Fulin(ABC)	Yang Ming sheng (ABC)
Banker	Shi Jiliang (ABC)	He Linxiang (ABC)		Liu Mingkang (BOC)		Jiang Jianqing (ICBC)	
Academia	Huang Da			Wu Jinglian		Li Yang	

Source: Chen Long, 'How does China's Monetary Policy Committee influence monetary policies?' Institute for New Economic Thinking, 2012.

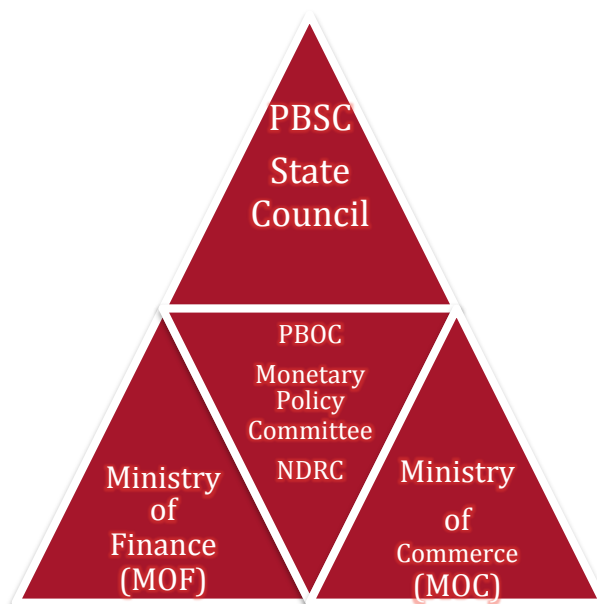
**Table 2-6. Monetary Policy Committee (2003.4 - current)**

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
PBOC Gnr	Zhou Xiaochuan									
State Council	You Quan				Zhang Ping	You Quan				
NDRC	Zhu Zhixin									
MOF	Jin Liqun	Li Yong								
PBOC D.Gnr	Wu Xiaoling					Yi Gang	Hu Xiaolian			
PBOC D.Gnr	Li Ruogu		Su Ning				Du Jinfu			
SAFE	Guo Shuqing		Hu Xiaolian				Yi Gang			
NBS	Li Deshui			QXH	Xie Fuzhan		Ma Jiantang			
CBRC	Liu Mingkang								Shang Fulin	
CSRC	Shang Fulin								Guo Shuqing	
CIRC	Wu Dingfu								Xiang Junbo	

CBA	Xiao Gang		Guo Shuqing	Jiang Chaoliang		Jiang Jianqing	
Academia	Li Yang	Yu Yongding	Fan Gang		Zhou Qiren	Song Guoqing	
Academia	N/E				Li Daokui	Qian Yingyi	
Academia	N/E				Xiabin	Chen Yulu	

Source: Chen Long, 'How does China's Monetary Policy Committee influence monetary policies?' *Institute for New Economic Thinking*, 2012.

**Figure 2-7. China's Trade & Macroeconomic Policy Formation Structure**



Source: By author

#### *National Development and Reform Commission (NDRC)*

Formerly the State Planning Commission (SPC, 国家计划委员会) - which managed China's central planned economy from Mao's years, the National Development and Reform Commission (NDRC, 国家发展和改革委员会) is still the most prominent agency under the State Council. While with the change of leadership and policy trends for development has compelled the NDRC to change from directing a centrally planned economy to making growth adjustments in a socialist market economy, thereby losing

some of its once-held influence, it still has direct authority with regard to distribution of fiscal and credit resources.<sup>109</sup> It also regulates prices in China's strategic sectors. Because it also has a stake in price control, it has been a major bureaucratic rival of the PBC. While the PBC cares more about inflation with regard to price stability, the NDRC cares more about growth. While the PBC favors the market-based approach, the NDRC prioritizes its administrative role in monitoring and forecasting the macroeconomy. On the other hand, the NDRC consults with the PBC with regard to many aspects in the monetary policy making spectrum because the PBC is the principal proposal originator of policies and holds exclusive expertise in the area.<sup>110</sup> While their power has diminished with regard to overall planning of the economy, the former top officials of the NDRC are now high-ranking members of the CCP (e.g., Ma Kai, who served as Chairman of the NDRC from 2003 to 2008, is now the 4<sup>th</sup> vice premier). The political connection with the CCP provides the NDRC the rationale and the foundation for retaining their foothold in the decision making process.

#### *Ministry of Commerce (MOC)*

A reorganization of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC, 对外贸易经济合作部) resulted in the formation of the Ministry of Commerce (MOC, 商务部) in the spring of 2003. While in Japan and South Korea, trade policies have been partially delegated to MOFA (although this is only the case in Japan from 2013), China's MOFA primarily concentrates on diplomatic affairs, with a strong

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<sup>109</sup> Bell and Fung, p.51.

<sup>110</sup> *Ibid.*, pp.119-120. This is the horizontal bargaining and coordination process within the Chinese bureaucracy. China and South Korea seem to share this core aspect of bureaucracy, while Japan shows deficiency of such processes.

concentration on security issues, and trade issues are completely at the MOC's discretion. Because MOC's constituencies are China's export industries, the MOC has advocated for a fixed exchange rate of the RMB to the USD. As China still depends heavily on trade, the MOC is quite desperate in defending the industries' interests and advocating such exchange rate policy. This builds confrontations with the PBC, which from 2003 has advocated for internationalization of the RMB, and further liberalization initiatives. The MOC continues to have conflict of interest with the PBC in this regard.

Instead, the MOC has been seeking to strengthen the foundations of its policymaking tools by focusing on trade remedy of AD, CVD, and safeguards. With a trade remedy bureau established internally, the MOC has sought to strengthen its presence and its foundations of political power in the Chinese bureaucracy by actively engaging in trade disputes at the international level. Since its accession to the WTO in 2001, China is one of the most actively involved member states in trade dispute settlement cases in the WTO, as complaint, respondent, and third party. In this respect, the MOF has been relatively less powerful than the MOC with regard to exchange rate policy making, because the MOC's coverage of policy agenda setting in the field has been built on stronger industrial interests.

#### *Ministry of Finance (MOF)*

China's Ministry of Finance (MOF, 财政部), also a pillar executing party guidelines, has been relatively on the decline in terms of its policy making power in the reform

decades – it has formal authority but it is in bureaucratic rivalry with the PBC.<sup>111</sup> Given this power contest, the MOF still has presence in the financial sector, as it controls the four main state-owned banks – the Bank of China (BOC), the Agricultural Bank of China (ABC), the Industrial and Commercial Bank of China (ICBC), and China Construction Bank (CCB) – and as it controls Central Huijin Investment Company (CHIC), which is the biggest shareholder of the banks. It has influence over the stock market via the National Social Security Fund and the China Investment Corporation (CIC), which is China’s sovereign wealth fund managing body. It makes the accounting rules and taxation policy in China.<sup>112</sup>

The backgrounds behind how the PBC has been able to rise up in policy making is found in its relationship of growing mutual dependency with the party leadership. The PBC has been increasing its policy weight in the past decades.<sup>113</sup> This is a big divergence from other ‘Confucian’ bureaucracies of China’s neighbors – South Korea and Japan – in which both countries have witnessed the central bank’s struggle for independence through major reform periods just after the Asian Financial Crisis, after suffering for years suffocating under powerful MOFs. In China, the MOF and the PBC have also undergone rivalries since 2003, especially in the field of exchange rate policymaking and financial sector reforms. The PBC is at the center of policy execution, and operates under the guidance and policy formulation of the Leading Group for Financial and Economic Affairs.

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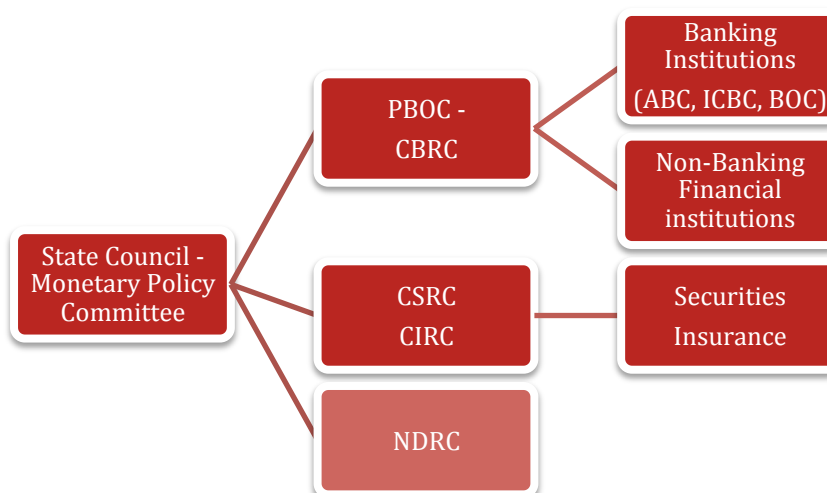
<sup>111</sup> 2008 Report to Congress of the U.S.-China Economic and Security Review Commission, U.S-China Economic and Security Review Commission, Washington, D.C.

<sup>112</sup> *Ibid*, p.52

<sup>113</sup> *Ibid*, 2013.

China's MOF is fairly weaker than other MOFs in other countries. In contrast to China's MOF, in South Korea and Japan, MOFs still enjoy a considerable level of authority, albeit the delegation of separated functions of banking supervision to an agency of that purpose at the end of the 1990s. The relatively weak MOF stance in policy making in China is due to the delegation of policy making and management to other government agencies. For instance, macroeconomic management is primarily handled by the National Development and Reform Commission (NDRC); the State-owned Assets Supervision and Administration Commission (SASAC) manages state-owned industries; and there are separate regulators for banking, insurance and securities (the CBRC, the CSRC, and the CIRC). Moreover, regulation of open market operations and management of interest rates are primarily handled by the PBC. In actuality, the MOF even has a weaker say than the MOC in exchange rate policy, as the MOC strongly pushes for its mandates of advocating China's export industries with low value of the RMB.

**Figure 2-8. China's Financial Regulatory System**



*Source: By author*

**Conclusion: Policy Variation in the Responses to U.S. Protectionism**

By examining the political capacities through political transitions, leaderships, and the government bureaucracies and actors involved in macroeconomic and trade policy agenda setting, we are able to witness differences amongst the three countries. Japan has seen decades of consistency in pursuing a responsive format in terms of policy under continued support for the LDP except for a few years when the DPJ was in power. South Korea has had multiple transitions in its political leadership, in which its bureaucratic functions were also reshuffled so many times, but all the while it has managed to retain bureaucratic that revolves around a very strong presidency. China managed to maintain a top-down political mechanism and bureaucracy despite its transition to a market-oriented economy after Deng Xiaoping's launch of economic reforms, but with a strong central bank setting macroeconomic policy agendas that are set by the Leading Group for Financial and Economic Affairs and executed by the PBC – these are bureaucratic characteristics that are difficult to find in Japan or South Korea.

We now understand that the three countries have shown different patterns of policy formation based on the inherent differences in the political structures in the government and the bureaucracy. So how do the different conditions of political climate and bureaucracy translate into the variance in the three countries' responses to U.S. protectionism? The following chapters (Chapter 3 and 4) will examine the specific cases of U.S.-Northeast Asian trade wars, in which an analysis on how the three countries have engaged differently in trade remedy in response to antidumping or countervailing duty impositions by the USITC or the USDOC and in response to WTO disputes initiated by

the U.S. in the WTO. Afterwards, the different responses to U.S. currency appreciation pressures via monetary policy mechanisms in the three countries will be explained via their exchange rate policies (Chapter 5).

## CHAPTER THREE

### East Asian Responses to U.S. Protectionist Actions, 1971-2013

“The U.S. Commerce Department disregarded the defense of the Chinese government and Chinese enterprises, and imposed unfair duties against China’s solar cell exports to the U.S. China is strongly dissatisfied with the ruling.”

-Shen Danyang, MOFCOM Spokesman on  
U.S. Final Ruling of AD and CVD Investigations against Imports of Chinese Solar Cells, October 10, 2012-

### **Examining the Recurring Cycle of Trade Protectionism**

Why do U.S. trade frictions with export-led economies occur, and why do the responses from U.S. trading partners vary? The WTO dispute settlement system has evolved into an effective ruling body for trade disputes concerning its member states. Before the WTO Dispute Settlement Body (DSB) came into being, however, the GATT system lacked effective mechanisms to adjudicate trade disputes. Accordingly, prior to the existence of WTO DSB, countries were left to build trade remedies on their own. The U.S. stands as one of the pioneering countries in developing its trade remedy framework during and after the GATT years. The U.S. use of trade remedies has been a crucial tool in circumventing potential impacts from import surges since the postwar period. From the 1970s onward, trade remedies have been used to curb threats from trading partners to the main pillars of the U.S. economy, especially manufacturing.

As explained in Chapter 1, U.S. current account deficits may only be a natural manifestation of being the key currency issuing country. The U.S. economy remains the largest economy in the world in terms of aggregate GDP, is the second largest trading economy after China's in terms of total GDP, and has the broadest range of trading partners. The more a country trades, the greater the chances are that it will have a trade dispute or experience a trade disruption. However, trade volumes may not be the sole cause of the high frequencies of U.S. trade disputes. It is more likely that there are several factors involved in the cyclical patterns of U.S. trade frictions with its trading partners. In the big picture, there is the common denominator of all trade disputes – import surges of tradable goods across the main industries of an economy, which result in the

accumulation of trade deficits. Thus far, political lobbying through the networked channels of U.S. trade policy making has made punitive measures possible where U.S. industries incur losses due to perceived unfair trading patterns of a U.S. trading partner. Second, the structure of the U.S. economy could contribute to the frequency of trade disputes. Looking into the dimensions of U.S. trade dynamics, we can easily find one crucial factor that adds to the frequency of U.S. trade disputes – manufacturing, is on the decline yet still significant in the U.S. economy and politics.

Although the U.S. economy performs very well in services, manufacturing accounts for about 15 percent of the share of GDP generated by the private sector in the U.S.<sup>114</sup> The rising wage in the U.S. has led to the loss of comparative advantage, and employment in U.S. manufacturing industries has been steadily declining. Consequently, the loss of comparative advantage has led to continuous offshoring to other countries for cheap labor in the face of competition from foreign products of lower price and comparable quality in the U.S. market. The manufacturing sector is closely linked with the employment rate in the U.S. and thus remains a very significant part of the U.S. economy. One in every five jobs in U.S. manufacturing is supported by exports of manufactured goods.<sup>115</sup> Political lobbying by the manufacturing sector in the U.S. is critical. Large U.S. manufacturing enterprises have played a vital role in supporting presidential election campaigns; in order to exert influence on policy making and actions on trade remedy. Declining industries and their local economic effects in certain states in

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<sup>114</sup> ‘Expanding Trade Through Services’, The Official Blog of ITA, USDOC (<http://blog.trade.gov/tag/supply-chain-competitiveness/>)

<sup>115</sup> Manufacturing and Construction Division, U.S. Census Bureau, 2009.

the U.S. that are politically powerful in trade politics have also contributed to U.S. trade policy. Such declining yet surviving traits of the U.S. manufacturing sector have continuously kept the doors open widely for policy discussions for decades with regard to how U.S. political leaders should react with regard to record high import surges and trade deficits.

As noted previously in Chapter 1, a focus on the manufacturing sector is critical in the analysis, as all three countries of Japan, South Korea, and China have vested interests in selling manufactured goods. The U.S. trades with a number of different countries, but trading with countries that are more competitive in manufacturing has been a visible and cyclical pattern over time. In addition, U.S. trade protectionism toward countries – especially those in East Asia - that rely considerably on manufacturing has been quite significant, and has accompanied strong political reactions. Nonetheless, cases of trade disputes in sectors other than manufacturing (i.e., agriculture, services) will also be closely examined throughout the chapter, as they continue to play an integral part of the U.S. economy and trade negotiation.

The main motivation for this chapter stems from seeking to understand U.S. trade policy in the context of trade remedy mechanisms. In addition to the understanding of how the U.S. sets its policy and legal grounds for trade remedy, the chapter will explain how procedures toward a trade dispute are carried out at home and abroad. For this purpose, I will examine cases of trade remedies set out by the USITC, a U.S. administrative bureau. In Chapter 4, I will go on to examine cases of disputes at the international level, in the WTO dispute settlement system. The goal of this chapter is to

build a typology of differing responses from the governments of U.S. trading partners in Northeast Asia – Japan, South Korea, and China, in the historical order in which U.S. bilateral trade disputes have emerged and unfolded.<sup>116</sup>

In anticipation of possible critiques that a cross-temporal analysis is not appropriate for addressing current trade trends, I justify my approach on the basis that a comparative analysis of consecutive periods captures the patterns of institutional behavior at the state level in response to the changes in the global economy, and thus deserves scholarly and policy-oriented attention. In addition, I also argue that an atemporal, three-country comparative analysis of decision making patterns in trade disputes can uncover implications for how bilateral trade disputes may unfold in the years to come, based on the precedents of the past. At the end of the day, the analysis will show that each country's response to U.S. protectionism is predictably different from the others'. This owes mainly to institutional differences in tackling trade remedy issues and taking legal actions, albeit the states share some similar features of policy actions over issues regarding overlapping industrial interests of manufacturing and other sensitive economic sectors. Embedded in the institutional stances would be the detailed characteristics of the trading sector at stake (i.e., size and influence), and bilateral political relationships at the time of the dispute that influences decision making at government levels.

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<sup>116</sup> Regionally, due to geographic proximity under the framework of NAFTA, Canada and Mexico take up a huge chunk of U.S. exports and imports. Excluding these countries in the top 15 trading partners list of the U.S. are a list of export-oriented countries focusing on manufacturing such as China, Japan, Germany, South Korea, India, and Taiwan. Countries that can offer raw commodities and energy supply such as Brazil, Venezuela, and Saudi Arabia, the Netherlands, and countries with a strong services sector such as Switzerland are also on the list, but have not stirred up trade conflicts to the extent that the aforementioned manufacturing-focused countries have with the U.S.

In this chapter, I investigate the varieties of responses to U.S. trade protectionism by analyzing two phenomena. First, I examine the cases of U.S. anti-dumping, countervailing duty, and safeguard investigations on Japan, South Korea, and China, and analyze each of their responses. Second, I compare and contrast the patterns of Japan, South Korea, and China's antidumping, countervailing duty, and safeguard investigations and actual levying of duties following the investigations to clearly trace the patterns of institutional decision-making procedures with regard to a trade remedy action at bilateral levels. The point of the argument here is that legal foundations and institutional processes involving tasks of trade remedy ultimately lead to the discrepancies in the number of investigations and punitive levies sought, and the nature of trade remedy systems – be it defensive, offensive, or neutral.

By explicitly laying out how each government has reacted with regard to each of the U.S. trade remedy measures, and by clarifying how each of the governments have constructed their own trade remedy mechanisms, this chapter will provide us with lenses to contrast why Japan, South Korea, and China are different in coping with the challenges of U.S. trade protectionism that is thrown at them. The evidence demonstrated in this chapter leads us to understand that while each of the bilateral trade relationships tend to appear similar in the discussions regarding mounting U.S. trade deficits, in actuality, trade remedy patterns vary a great deal due to the differences in developing the trade remedy mechanisms and in the degrees of effective utilization of the trade remedy system. In the end, this chapter will conclude with policy implications for the U.S. and the three countries – ramifications with regard to the endless, recurring cycles of U.S. trade

protectionism, and careful projections of how each of the bilateral trade remedy patterns might look in the future.

### **Revisiting the Analytical Framework**

In uncovering the different patterns of policy responses and approaches of each country toward U.S. AD and CVD investigations, I argue that the variations of policy actions derive from the structures of decision-making and procedures of policy execution and administering. As argued in Chapter 2, each country will differ with regard to political capacity in carrying out the disputes (both as a respondent and an initiator), and government institutions that deal with the cases will act based on existent domestic law and on considerations of its industrial interests throughout the process. The empirical findings on Japan, South Korea, and China will demonstrate in what specific ways the differences among the countries arise – in the aspects of legal provisions, and the policies that have been shaped by each ministry and/or bureau in charge of trade remedy. Based on my institutional framework presented in Chapter 2, the empirical findings in this chapter suggest that the variance amongst the three countries in their responses to U.S. protectionism results from different trade policies, strategies, and execution of policies. Thus, the goal of the chapter is to demonstrate the effects of the political decision making processes in trade policy making for each country.

In carrying out my case analyses, I place my emphasis on the ‘recurring cycles’ of U.S. protectionism. *Ceteris paribus*, the mechanisms of U.S. protectionism in the postwar years have been consistent in each of the cases that I present. While it is difficult to deny that the degree of U.S. pressures may have varied from case to case, and that such

pressures may have an effect on how a country decides to respond, the degree of U.S. pressure alone certainly cannot account for what the responding country would actually decide to do or what policy tools it would use. The atemporal comparative analysis in this chapter aims at capturing the conditions in each country for fighting trade wars that persist to this day and demonstrate continuing policy relevance.

### **Case Analysis and Methodology**

#### *Country Responses to USITC AD/CVD Cases and WTO Cases*

Painting a bigger picture of the recurring cycles of U.S. protectionism helps us to better understand the cyclical nature of U.S. pressures. The first and foremost reason for selecting Japan, South Korea, and China for this research is the existence of cyclical patterns of U.S. trade wars that were apparent in the bilateral economic relationships. The stages of U.S. trade conflicts on each of the countries have had similar patterns. (See **Figure 1** in Chapter 1.) All in all, the recurring cycles of U.S. protectionism and the common stages of trade wars between the U.S. and the Northeast Asian economies of study – lead us to believe that there is a case for comparing the differing responses of the states.

Of primary interest in the case analysis is the role of institutions and political decision-making on the basis of industrial interests toward AD/CVD investigations and dispute initiations. The focus and objective of the analytical task is to capture the different patterns of behavior by country throughout the chronological flow of AD/CVD cases. The goal of the analysis is to investigate the pathways of decision-making and the roles of agencies associated with the AD/CVD investigations and dispute initiation at both

domestic and international levels. In order to test my hypothesis of institutional effects on the variance of responses to U.S. protectionism, I conduct analyses of three components of bilateral trade remedies – 1) USITC initiation of AD/CVD investigations against the three countries, 2) the responses to those investigations by the three East Asian economies, and 3) AD/CVD initiations by trade remedy bureaus in Japan, South Korea, and China – in purpose of understanding the characteristics of each country’s trade remedy system. All three components of the analysis will involve understanding the legal foundations and government procedures of filing AD/CVD cases in each country, which involves economic sectors, strategic industries, and products that contribute to the final decisions made in each investigation. The cases will be analyzed in chronological order by country and by industrial sector. The analysis focuses on cases that represent businesses that have faced fierce competitions.<sup>117</sup>

### **U.S. Legal Foundations for Trade Remedy**

#### *The Sources for Wielding Power at Home and Abroad*

There is no question that the U.S. has been actively pursuing trade liberalization under globalization to this day. Nonetheless, it is also important to note that policy measures to protect several important sectors of the U.S. economy have concurrently been a vital and consistent tool in U.S. trade policy in the past decades. Given the pluralistic nature of the U.S. political decision- making process, the U.S. trade policy revolves around four major actors: the Congress, the President, the Administration (USDOC), and the industries that lobby the Congress. Partnership and rivalry among the executive, administrative, and

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<sup>117</sup> All of the three countries have commonly traded goods with the U.S. – automobiles (whole and parts), semi-conductors, and electronics, and have faced trade remedy measures.

legislative branches have played a crucial role in trade policymaking processes, on which the U.S. has built its expertise based on evidence and precedence.<sup>118</sup> The Congress has the authority over trade policy with foreign countries, and the President has authority over diplomatic affairs with foreign countries, but in the case of a conflict between the two actors over trade matters, the Supreme Court has thus far upheld the position of the U.S. Congress.<sup>119</sup>

The tools for wielding power in U.S. trade policy can be simply categorized into two levels: domestic and international. Domestic procedures involve accommodating the interests of industries, congressional decisions, and unilateral initiation of investigations for trade remedy at the state level. The domestic procedures are not identical to WTO dispute initiations, though they may be convened for the same purpose of trade remedy. As we will see in Chapter 4, procedures of trade dispute initiation at the international level are also convened in a bilateral, state-to-state format in the beginning stage prior to a WTO panel setup; however, once the panel is set, the WTO dispute settlement body acts as the arbiter and cases often include the additional presence of third party observer countries that also have a stake in the trade dispute issue at stake. It is important to note that under the current procedures of the WTO dispute initiations, a panel for the dispute settlement in the WTO is established only when the two parties (sovereign states that are both WTO members) involved cannot reach an agreement to mitigate the trade conflict at issue during the consultation stage prior to panel establishment.

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<sup>118</sup> Cohen, Pael, and Becker, 1996.

<sup>119</sup> Feller, Peter B. and Wilson, Ann C., 1976. 'United States Tariff and Trade Law: Constitutional Sources and Constraints', *Law & Policy in International Business*, Vol.8, No.1. p. 111. The authors write that the Supreme Court has on only two occasions, both in 1935, held an act of Congress invalid because of an unconstitutional delegation of authority to the President. Richard Baldwin (1985) reemphasizes this point.

In the domestic procedures, in which a petition by a company of a certain industry is brought to initiate an antidumping or countervailing duty investigation, the United States International Trade Commission (USITC), a quasi-judicial, independent agency, plays the central role and reports to the President, the United States Trade Representative (USTR), and the United States Congress. Administratively, the United States Department of Commerce (USDOC) has been relegated the institutional authority regarding antidumping investigations from the United States Department of Treasury in 1980, which brought an exponential surge in the number of cases filed, because the USDOC took a broader approach to accepting petitions from firms than the Department of Treasury previously did.<sup>120</sup> In the cases taken to the international level, industrial interests are aggregated and assessed by the USTR, a part of the Executive Office of the President, and cases are filed in the WTO for litigation. Prior to the establishment of the WTO Dispute Settlement Body, trade disputes under the GATT system were mostly handled by bilateral negotiations and unilateral trade remedies.

The U.S. government is equipped with the legal mechanisms and means to initiate investigations, with the legal texts stipulating sufficient grounds for investigations. These laws are jointly administered by the USITC and the USDOC.<sup>121</sup> If one were to trace back in U.S. trade policy history, the root of protectionism can be found in the *Smoot-Hawley Tariff Act of 1930*, which raised U.S. tariffs to record levels at the time to protect U.S.

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<sup>120</sup> Irwin, 2005.

<sup>121</sup> Carpenter, 2008.

farmers from foreign agricultural producers.<sup>122</sup> While tariff levels have dropped far below Depression-era levels, Smoot-Hawley is a source of protectionist measures U.S. trade policy. Section 1677 of the statute explicitly states the grounds for punitive measures on dumping and countervailing duty.<sup>123</sup>

Currently, the Smoot-Hawley Act has been revoked and while the Act is still in the books, it is only applied to imports from very few countries like Cuba and North Korea, countries to which MFN (PNTR) status do not apply.<sup>124</sup> (The case for Cuba may change should the U.S. normalize its relations with Cuba, as the issue is being discussed in U.S. policy.) After years of criticisms and blames on the Act for contributing to the Great Depression, the U.S. has shifted its gears to trade liberalization. However, it is quite evident that the origins of protectionism can be found in the Smoot-Hawley Act, and that it had indeed been a cornerstone in the history of U.S. trade policy, and the remnants of the Act are apparent in the legal texts for antidumping and countervailing duty investigations.

### *Antidumping*

Economist Douglas Irwin contends that U.S. antidumping law as we see today was established by the *Antidumping Act of 1921*.<sup>125</sup> It basically contains four main parts: 1)

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<sup>122</sup> Economists tend to argue that the Smoot-Hawley Act aggravated the U.S. economy under the Great Depression at the time. For details see Irwin, 2012.

<sup>123</sup> <http://www.law.cornell.edu/uscode/text/19/1677>

<sup>124</sup> Hornbeck and Cooper, 2014. <http://fas.org/sgp/crs/misc/RL33743.pdf>

<sup>125</sup> Irwin, 2005. The preexisting Antidumping Act of 1916 was challenged by the EU and Japan in 2000 based on the notions it does not have a material injury test as required by the Uruguay Round's Antidumping agreement, through the DSB in the WTO, in which the panel ruled that it is inconsistent with GATT 1994. See cases on the U.S. Anti-Dumping Act of 1916 filed each by the EU in 1998 (DS136, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds136\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds136_e.htm)) and by Japan in 1999 (DS162, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds162\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds162_e.htm)).

that duties may be imposed if the exporter's sale price is *less than the foreign market value*, 2) that foreign costs of production may be calculated if the foreign market value is not ascertainable, and 3) that dumping must be related to injury suffered by the domestic industry, and 4) that higher import duties are the appropriate remedy. U.S. antidumping law was substantively changed when this act was replaced by *Title I of the Trade Agreements Act of 1979* and a new *Title VII to the Tariff Act of 1930* was appended, ultimately adding more speed and efficiency to the administering of the antidumping law.<sup>126</sup>

'Dumping' is defined as selling at '*less than fair value*' (LTFV), or more specifically the act of selling a product in the U.S. market at a price that is lower than the price for which it is sold in the home market (the "normal value"), after adjustments for differences in the merchandise, quantities purchased, and circumstances of sale. In the absence of sufficient data on home market sales, investigators may refer to the price for which the product is sold in a surrogate 'third country,' and in the absence of third country sales, a cost-plus-benefit approach to arrive at a normative value labeled as 'constructed value' is used to assess the act of dumping.<sup>127</sup>

A total of 287 days minimum to 427 days maximum is required toward the final decision on the levy of antidumping duties, as seen in the flowchart in **Figure 3-1**. Nonetheless, once a positive preliminary decision has been reached for antidumping duty levy, provisional measures halting tariff calculations or deposit requirements of cash or

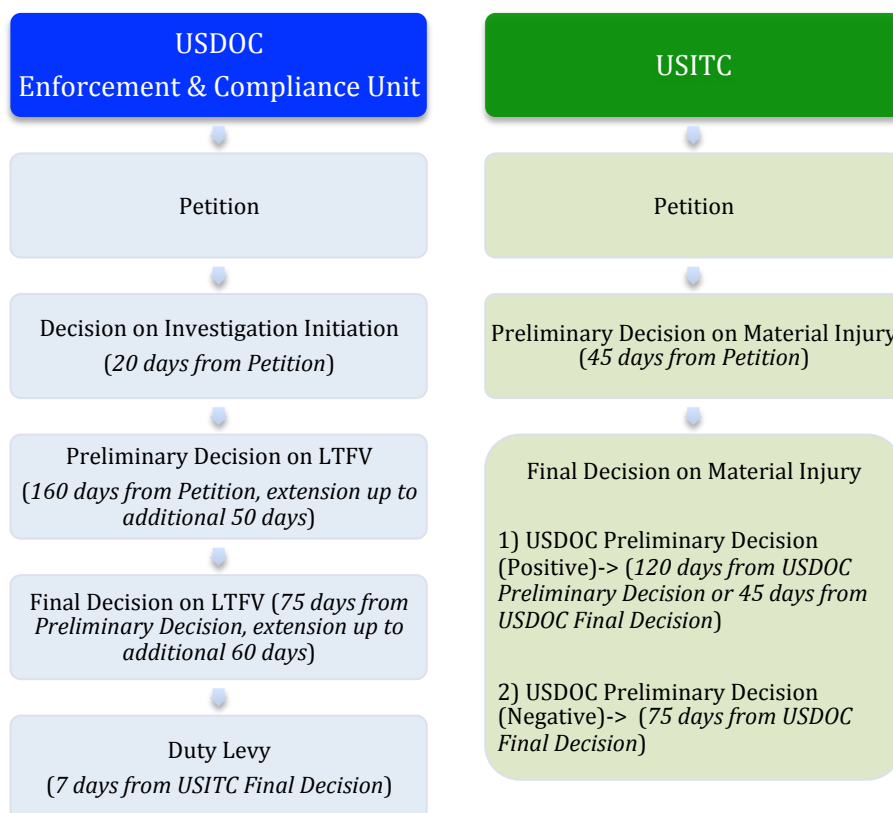
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<sup>126</sup> Irwin, *ibid.*

<sup>127</sup> Carpenter, *ibid.*

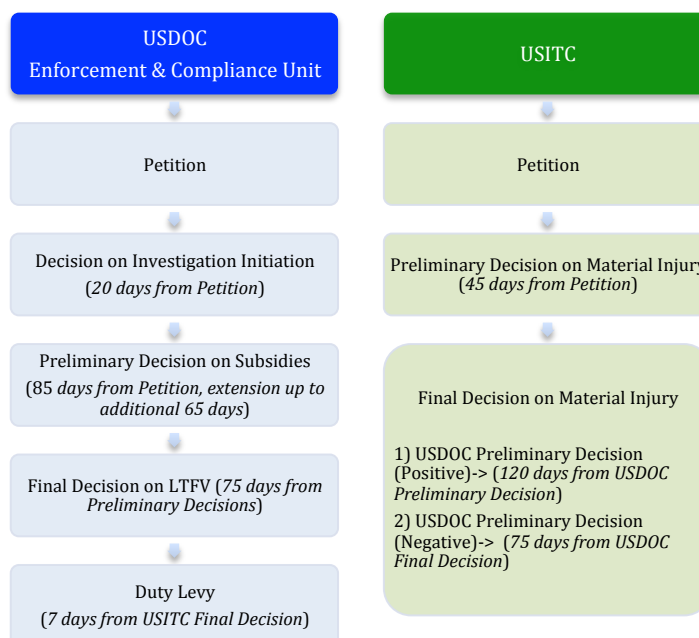
collateral may take place. These provisional measures allow for the effects of antidumping decisions to be apparent from an early stage.

**Figure 3-1. United States Antidumping Investigation Procedures by the USDOC and the USITC**



Source: By author based on the AD investigation procedures of the USDOC and the USITC

**Figure 3-2. United States Countervailing Duty Investigation Procedures by the USDOC and the USITC**



*Source: By author based on the AD investigation procedures of the USDOC and the USITC*

### *Countervailing Duty*

‘Countervailing Duty’ is defined in the statute as ‘a duty levied on an imported good to offset subsidies to producers or exporters of that good in the export country’. In simple terms, when a government or any public entity within the territory of the country provides 1) a financial contribution, 2) any form of income or price support within the meaning of Article XVI of the GATT 1994, or 3) a payment to a funding mechanism to provide a financial contribution to a person and thereby a benefit is conferred, a subsidy is deemed to have occurred. The current U.S. laws on countervailing duty are based on Section 701 of the Smoot-Hawley Tariff Act of 1930, with most recent revisions done in June 1997 to reflect updates from the Marrakesh Agreement concluding the Uruguay Round. Because the WTO has come to place stricter rules on government subsidies, the

number of countervailing duty investigations by WTO members at their domestic institutions have been generally on the decline. The procedures of countervailing duty investigations follow a similar format to antidumping investigations by the USDOC and the USITC.

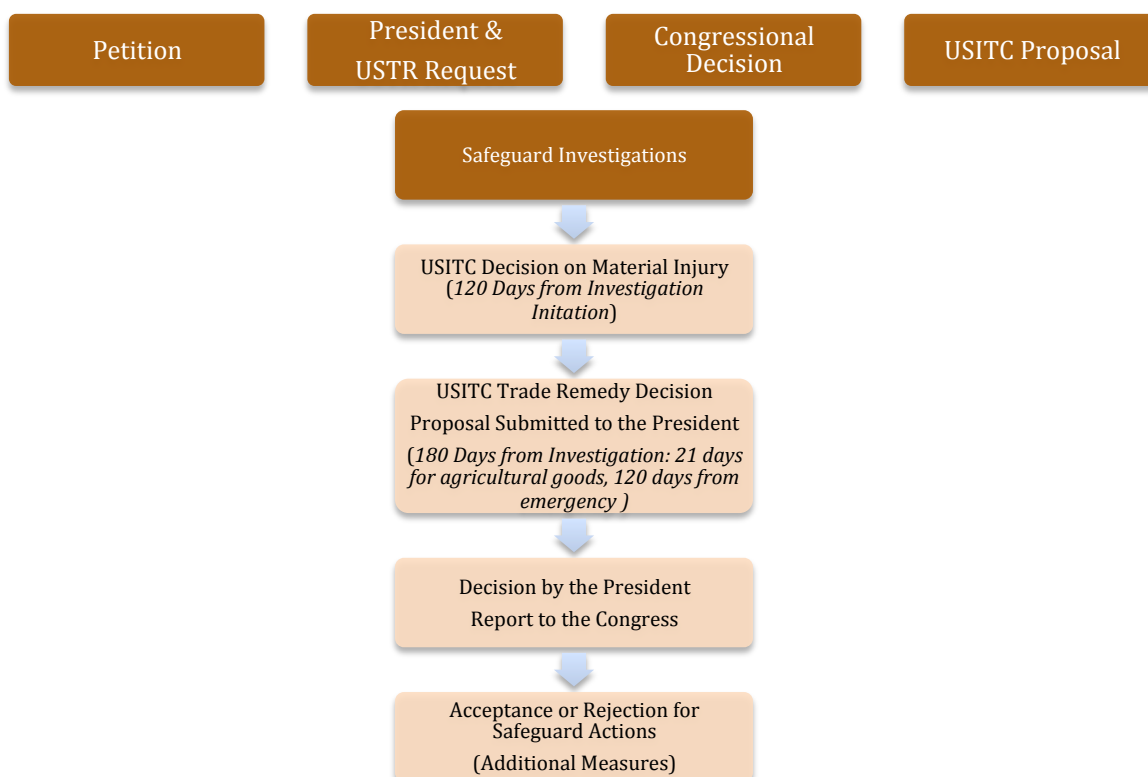
### *Safeguard*

There are two sections that serve as the legal ground for Safeguard investigations in U.S. trade remedy. First, Section 201 of the Trade Act of 1974 (Global Safeguard Investigations), Import Relief for Domestic Industries - or Section 201, as referred to in shorthand, is a section of the Trade Act of 1974 (P.L. 93-618) that permits the President to grant temporary import relief, by raising import duties or imposing nontariff barriers on goods entering the United States that injure or threaten to injure domestic industries producing like goods. This provision is the analog of GATT Article XIX, which allows GATT contracting parties to provide relief from injurious competition when temporary protection will enable the domestic industry to make adjustments to meet the competition.

Second, there are Section 421 and 422 of the Trade Act of 1974 (China Safeguard Investigations). Section 421 implements the transitional safeguard contained in Section 16 of China's Protocol of Accession to the WTO. Section 422 provides the USITC the authority to recommend a remedy to the President and the USTR upon making an affirmative determination of a) an action by China to prevent or remedy market disruption in a WTO member country or b) an action by a WTO member to prevent or

remedy market disruption from imports from China that threatens to cause a significant diversion of trade into the U.S. domestic market.<sup>128</sup>

**Figure 3-3. United States Safeguard Investigation Procedures by the USDOC and the USITC**



*Source: By author based on the Safeguard investigation procedures of the USDOC and the USITC*

### *Trade Disputes and Enforcement*

U.S. trade disputes and enforcement of trade remedy policies are based on Section 301 of the Trade Act of 1974 and Section 337 of the Trade Act of 1930. Section 301 of the Trade Act of 1974, or better known as ‘Super 301’, provides strong rules for enforcement of trade rules and trade sanctions by the U.S. It provides the U.S. with the authority to enforce trade agreements, resolve trade disputes, and open foreign markets to U.S. goods

<sup>128</sup> USITC, Understanding Safeguard Investigations ([http://www.usitc.gov/press\\_room/us\\_safeguard.htm](http://www.usitc.gov/press_room/us_safeguard.htm))

and services.<sup>129</sup> The U.S. imposes trade sanctions on foreign countries based on this statute, and files for consultation in the WTO prior to panel establishment involving a trade rule violation. The U.S. may take actions to raise import duties on a certain product based on this act. By statute, the USTR negotiates a settlement with a foreign country to resolve trade disputes upon initiating a Section 301 investigation. This law was the basis of bilateral negotiations on trade remedy regarding semiconductors between U.S. and Japan. During the Clinton Administration in the 1990s, Super 301 was reinstated and gave impetus to bilateral negotiations to resolve trade issues between the U.S. and South Korea.<sup>130</sup>

Section 337 of the Trade Act of 1930 is the basis of investigations largely involving infringement of U.S. copyrights (utility and design patents, registered common law trademarks) and intellectual property issues. The primary remedy suggested by this act is to issue an exclusion order for the U.S. Customs to stop infringing imports from entering the U.S. territory.<sup>131</sup> Secondary remedies include temporary exclusion orders of products in the case that there is reason to believe Section 337 has been violated. Other remedies include cease and desist orders in which investigation is conducted without exclusion of

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<sup>129</sup> International Trade Administration, USDOC ([http://www.trade.gov/mas/ian/tradedisputes-enforcement/tg\\_ian\\_002100.asp](http://www.trade.gov/mas/ian/tradedisputes-enforcement/tg_ian_002100.asp))

<sup>130</sup> The original Super 301 provisions expired in 1991, and President Clinton's executive order 12901 reactivated Super 301 for the years 1994-95. It was extended through 1997 via executive order 12973, and reinstated again in 1999 for another three years through executive order 13116, but the original Super 301 varied from the existing Section 301 in that it made imposition of trade remedies automatic if the President does not override the decision.

<sup>131</sup> USITC, Intellectual Property Infringement and Other Unfair Acts ([http://www.usitc.gov/intellectual\\_property/](http://www.usitc.gov/intellectual_property/))

orders into the U.S. territory, or a civil action if the respondent fails to comply with a cease and desist order.<sup>132</sup>

### **United States Trade Remedy Measures on Japan, South Korea, and China**

In understanding the structure of the U.S. trade remedy system, two major actors come into play: the U.S. Department of Commerce (USDOC) and the U.S. International Trade Commission (USITC). Petitions are filed simultaneously with both institutions, but they play separate yet dependent roles during the course of the investigation. The USDOC is a government ministry that has the sole authority to initiate or not initiate the investigation, and to analyze sales and cost from the perspective period of investigation to determine whether dumping occurred.<sup>133</sup> Detailed investigations are conducted by the Enforcement and Compliance Unit (formerly the Import Administration: IA), placed under the International Trade Administration (ITA), a subsidiary bureau of the USDOC.<sup>134</sup> The Enforcement and Compliance unit is made up of three offices: Antidumping and Countervailing Duty Operations, Policy and Negotiations, and Foreign Trade Zones. During the investigation, foreign companies are asked to open up their books for evidence of dumping, which can result in controversy at times.

Composed of six Commissioners and six Administrative Law Judges nominated by the U.S. President, the USITC plays the role of a court responsible for determining whether a domestic industry is materially injured or threatened with material injury as a

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<sup>132</sup> 'A Brief Overview of Practice Under Section 337', FindLaw (<http://corporate.findlaw.com/litigation-disputes/a-brief-overview-of-practice-under-section-337.html>)

<sup>133</sup> Differences of the DOC and the ITC ([http://enforcement.trade.gov/petitioncounseling/pcp-faq.html#A\\_1](http://enforcement.trade.gov/petitioncounseling/pcp-faq.html#A_1))

<sup>134</sup> About the International Trade Administration (<http://trade.gov/about.asp>)

result of the individual and cumulated impact of the allegedly dumped imports.<sup>135</sup> Due to its missions of independent judgment and impartiality, the USITC is not a government body directly placed under the Presidency and the Administration, but rather an autonomous body that analyzes domestic industries of the U.S.

In a nutshell, the USDOC is a government body that decides whether or not an anti-dumping or countervailing duty should be levied, and the USITC is an independent body that judges whether a material injury has incurred for a specific domestic industry. Once the two institutions start an investigation, the President has no way to forestall the investigation. The upside of this structure is that the U.S. is able to levy duties despite political difficulties – investigations are convened in a more bureaucratic way than political.<sup>136</sup> The downside is the uncertainty regarding how long the levied duties can stay in place. They are levied for a minimum of 5 years, and can be re-imposed multiple times upon reassessment, through a procedure called ‘sunset review’.

With regard to the upsurge of trade remedy investigations in recent decades, Douglas Irwin has noted that it is untrue that there were no investigations at all before 1980, but it is true that before 1980 many investigations did not result in imposition of a duty.<sup>137</sup> For this reason, many economists believe that AD/CVD measures were not enforced heavily before 1980. Irwin notes the transfer of authority for AD/CVD investigations from the Treasury Department to the Department of Commerce at the end of the 1970s, and

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<sup>135</sup> USITC Staff Directory ([http://www.usitc.gov/documents/staff\\_directory.pdf](http://www.usitc.gov/documents/staff_directory.pdf)); Differences of the DOC and the ITC ([http://enforcement.trade.gov/petitioncounseling/pcp-faq.html#A\\_1](http://enforcement.trade.gov/petitioncounseling/pcp-faq.html#A_1))

<sup>136</sup> It is important recognize that within the United States, interests surrounding trade remain divided. Proponents of free trade (i.e., the Cato Institute) tend to emphasize that it is the U.S. consumers who will need to pay for the high prices of goods instead of buying cheap foreign goods should AD/CVD rules continue to be enforced. For example, Lindsey, Griswold, and Lukas (1999) of the Cato Institute find that

<sup>137</sup> Irwin, IMF Working Paper, 2005.

attributes the proliferation of AD/CVD case filings from 1980 to the USDOC's greater openness to accepting petitions.

The database on U.S. AD/CVD investigations year-to-date under the Enforcement and Compliance bureau of the U.S. International Trade Administration, the U.S. Department of Commerce, is readily available online.<sup>138</sup> U.S. antidumping investigation data is available from the year 1921, in which the Antidumping Act was enacted. Countervailing data dates back to the year 1897. Orders that were revoked are categorized separately as historical data. Orders that are still in place are divided into time periods of before the year 2000 and after the year 2000, as seen in **Table 3-1**. While it is not made clear why the year 2000 was chosen as the dividing year in data collection, it is possible to speculate that a) the USDOC sought to organize its data before and after the start of the new millennium after recognizing that there was a stark divide in the figures and found implications, and also that b) China's accession to the WTO in 2001 and the increasing number of trade remedy cases involving China may have contributed to that specific year selection. Meanwhile, the number of safeguard investigations is fewer than AD or CVD investigations, because they rarely occur.

**Table 3-1. U.S. Antidumping and Countervailing Duty Investigations (March 15, 2013 present)**

Country	Cases filed until December 31, 1999			Cases filed from January 01, 2000		
	<i>Antidumping</i>	<i>Countervailing Duty</i>	Total	<i>Antidumping</i>	<i>Countervailing Duty</i>	Total
<i>Japan</i>	124	3	127	13	0	13
<i>South Korea</i>	60	18	78	19	6	25
<i>China</i>	70	4	74	95	34	129
<b>Total</b>	154	25	279	127	40	167

<sup>138</sup> Enforcement and Compliance of the United States International Trade Administration, formerly the Import Administration (<http://ia.ita.doc.gov/stats/iastats1.html>)

Source: Author's calculations from Spreadsheet Data, International Trade Administration, U.S. Department of Commerce

**Table 3-2. Harmonized System Section Headings and Descriptions**

Section	Description
I	Live Animals; Animal Products
II	Vegetable Products
III	Animal or Vegetable Fats and Oils and Their Cleavage Products; Prepared Edible Fats; Animal or Vegetable Waxes
IV	Prepared Foodstuffs; Beverages, Spirits and Vinegar; Tobacco and Manufactured Tobacco Substitutes
V	Mineral Products
<b>VI</b>	<b>Products of the Chemical or Allied Industries</b>
<b>VII</b>	<b>Plastics and Articles Thereof; Rubber and Articles Thereof</b>
VIII	Raw Hides and Skins, Leather, Furskins and Articles Thereof; Saddlery and Harness; Travel Goods, Handbags and Similar Containers; Articles of Animal Gut (Other than Silk-Worm Gut)
IX	Wood and Articles of Wood; Wood Charcoal; Cork and Articles of Cork; Manufactures of Straw, of Esparto or of Other Plaiting Materials; Basketware and Wickerwork
X	Pulp Of Wood or of Other Fibrous Cellulosic Material; Recovered (Waste and Scrap) Paper or Paperboard; Paper and Paperboard and Articles Thereof
<b>XI</b>	<b>Textiles and Textile Articles</b>
XII	Footwear, Headgear, Umbrellas, Sun Umbrellas, Walking-Sticks, Seat-Sticks, Whips, Riding-Crops and Parts Thereof; Prepared Feathers and Articles Made Therewith; Artificial Flowers; Articles of Human Hair
XIII	Articles of Stone, Plaster, Cement, Asbestos, Mica or Similar Materials; Ceramic Products; Glass and Glassware
XIV	Natural or Cultured Pearls, Precious or Semi-Precious Stones, Precious Metals, Metals Clad with Precious Metal and Articles Thereof; Imitation Jewelry; Coin Thereof; Imitation Jewelry; Coin
<b>XV</b>	<b>Base Metals and Articles of Base Metal</b>
<b>XVI</b>	<b>Machinery and Mechanical Appliances; Electrical Equipment; Parts Thereof; Sound Recorders and Reproducers, Television Image and Sound Recorders and Reproducers, and Parts and Accessories of Such Articles</b>
XVII	Vehicles, Aircraft, Vessels and Associated Transport Equipment
XVIII	Optical, Photographic, Cinematographic, Measuring, Checking, Precision, Medical or Surgical Instruments and Apparatus; Clocks and Watches; Musical Instruments; Parts and Accessories Thereof
XIX	Arms and Ammunition; Parts and Accessories Thereof
XX	Miscellaneous Manufactured Articles
XXI	Works of Art, Collectors' Pieces and Antiques

Source: WTO ([http://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_statindex\\_e.htm](http://www.wto.org/english/tratop_e/adp_e/adp_statindex_e.htm))

Based on the WTO Harmonized Section Headings in **Table 3-2**, **Table 3-3** and **Table 3-4** each represent sectors that have resulted in domestic initiations of antidumping and countervailing duty investigations in China, Japan, South Korea, the U.S. and the EU. The data are based on each of the member reports submitted to the WTO. The tables of the investigations indicate that the overlapping sectors of vested interests, which mainly fall into the categories of chemicals, textiles, metals, steel, and electronic machinery, that seek trade remedy institutions at home.

**Table 3-3. Antidumping Sectoral Distribution of Measures: By Reporting Member of the WTO (January 1, 1995 - December 31, 2012)**

Member	I	II	IV	V	VI	VII	IX	X	XI	XII	XIII	XIV	XV	XVI	XVII	XX	Total
China	1	1		4	81	36		10	3			13	1	2	4		156
Japan					4				3								7
ROK					18	7	4	9	5		2		6	19		2	72
US	11	10	8	4	44	22	3	10	12		4		163	15	2	4	312
EU	4	2	1	3	61	19	9	1	23	7	5		104	31	8	3	285

Source: WTO ([http://www.wto.org/english/tratop\\_e/adp\\_e/AD\\_Sectoral\\_MeasuresByRepMem.pdf](http://www.wto.org/english/tratop_e/adp_e/AD_Sectoral_MeasuresByRepMem.pdf))

**Table 3-4. Countervailing Sectoral Distribution of Measures: By Reporting Member of the WTO (January 1, 1995 - December 31, 2012)**

Member	I	II	III	IV	V	VI	VII	IX	X	XI	XIII	XV	XVI	XVII	Total
China		1	1									1		1	4
Japan													1		1
ROK															0
US	1	1		2	4	6	3	2	5	2	1	43	5		75
EU	1				1	2	8		1	5		8	4		30

Source: WTO ([http://www.wto.org/english/tratop\\_e/scm\\_e/CV\\_Sectoral\\_MeasuresByRepMem.pdf](http://www.wto.org/english/tratop_e/scm_e/CV_Sectoral_MeasuresByRepMem.pdf))

## The Responses

In this section, I present a comparative analysis on how Japan, South Korea, and China each responded to U.S. AD/CVD investigations. In particular, the analysis will focus on how each of the policy measures in response were based on their disparate legal foundations and institutional mechanisms that ultimately led to decision-making patterns in the ministries. In addition, in portraying how the three states have differed in developing their own mechanisms of AD/CVD investigations and the degree of their perusal of the systems, the section contends that Japan has acquiesced, South Korea has reciprocated, and China has retaliated against U.S. protectionist measures.

While the method of comparison I have chosen is based on the absolute number of cases that each country has initiated, the designation and labeling of patterns of

acquiescence, reciprocation, and retaliation are based on relative comparisons amongst the three countries' responses. It is important to note that my assessment of country responses is based on the relative comparison amongst the three states' trade remedy systems. At one glance, it is apparent that each of the countries under examination has some sort of a defensive mechanism – not surprisingly, as states are apt to build systems of defensive policies upon being attacked. However, the comparative tool will enable us to see the details of each state's response relative to the others. The degrees and dimensions of the policy responses by the three countries have clearly been different; and for the most part, differing institutional mechanisms of trade remedy have resulted in the different trade remedy policy patterns of each country that we see today.

#### *Japan's Acquiescence*

Tracing back the AD/CVD orders that were revoked before 1980, it is easily recognizable that the U.S. had started antidumping investigations against Japan since 1921, beginning with hand-hooked cotton rugs.<sup>139</sup> <sup>140</sup> Since then, the U.S. conducted antidumping investigations throughout the prewar and postwar years, but either failed to prove either that Japanese products were selling at lesser than fair value in U.S. markets, or that a material injury to the competing U.S. industry had been caused. Therefore, no antidumping duties had been levied.

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<sup>139</sup> Eckes, 1995. pp. 275-275. Eckes finds that before 1970, less than 5 percent of dumping complaints led to antidumping orders. It was with the Trade Agreements Act of 1979 that the U.S. saw a golden era of AD enforcement. The success rate of AD orders were highest against Asian dumpers like Japan, China, South Korea, and Taiwan, and lowest against Canada and Western Europe.

<sup>140</sup> Michael Moore writes that among the pre-1980 cases, almost 70% (13 out of 19 cases) were revoked due to lack of domestic interest in their continuation. See Michael Moore's manuscript, 'An Econometric Analysis of US Antidumping Sunset Review Decisions' (<http://home.gwu.edu/~mom/sunsetpred.pdf>).

Nevertheless, from the early 1960s, trade frictions emerged that centered on cheap Japanese natural and synthetic textile products that were sold in the U.S. market. During the U.S.-Japan textile negotiations, which lasted from 1960 to 1972, the U.S. demanded not only Japan, but also South Korea, Taiwan, and Hong Kong voluntarily restrain their exports of woolen and chemical/synthetic textiles to the U.S., and suggested that a conference be held on textiles at the GATT. Facing vehement anti-regulation demonstrations in the textiles industries at home, the Japanese Diet, together with its ministries spearheaded by the MITI (what is now METI), was initially in line with the anti-regulation campaign, but as the negotiations unfolded, the MITI turned to the textile industry for cooperation to meet U.S. demands. After a groundbreaking all-around VER statement offer from the Japanese side had been declined by President Nixon, a memorandum of understanding on voluntary export restraints of textiles was signed between the U.S. and Japan, and MITI made no further efforts to persuade the industry in 1971.<sup>141</sup> The contents of the memorandum largely reflected the original demands of the United States. Japan had acquiesced to U.S. pressures, and went on to participate in the signing of the Multifiber Agreement (MFA) of 1974, adopted by the GATT Council. The U.S.-Japan textile negotiations and its outcome was a reflection of relative power positions of the two countries at the time.

Japan also faced contention with the U.S. and was pressured to restrict its exports of steel from the 1970s and into the 1980s. AD investigations were initiated on steel products (i.e., steel pipes and tubes, stainless clad steel plate, steel wire nails, stainless

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<sup>141</sup> Sumiya, 2000. pp. 465-467.

steel pipes and seamless tubes). They did not lead to the actual levying of AD duties, but rather exacerbated contentious bilateral negotiations on VER. Among the many categories of Japanese exports during the era, the very first case that led to a U.S. levy of antidumping duties on Japanese goods was on Japanese TV sets (A-588-015). The antidumping investigation started in March of 1968 and as an outcome of the investigation, the case for Japanese TV sets selling at LTFV in the U.S. market was proved, in addition to a decision on March 9, 1971 that material injury had been caused to U.S. industries.<sup>142</sup> Industry petitions and antidumping investigations since that year and onwards were centered on electronics (whole and parts), heavy engineering parts, steel, chemical products, and semi-conductors.

As globalization progressed and the Japanese economy grew more open to the world, U.S. antidumping investigations on Japan have decreased considerably since the year 2000. The investigations of Japanese goods fall in the same industrial categories today as in earlier years, but as shown in **Table 3-1**, the number of U.S. AD/CVD investigations on Japan after the year 2000 decreased by almost 90 percent of the number of cases before 2000. It is also notable that no countervailing duty investigations were initiated against Japanese companies since 2000. With regard to anticipated findings of Japanese responses to these figures, the significant decrease in the numbers of investigations lead us to believe that the import surge that used to come mainly from Japan started to come from China from 2000 and onwards. Due to China's low labor cost, Japanese exporters

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<sup>142</sup> This case (A-588-015) appears in the Historical Information (Orders Revoked Before 1980) data, as well as in the AD/CVD investigations (Federal Register History) data before 2000. After sunset reviews, the order for this case was revoked on November 23, 1998, which went into effect on January 1, 2000.

had lost price advantage. Moreover, it had become increasingly difficult for the U.S. to detect or prove Japanese dumping cases. The Japanese trade surplus has been on the rise in the late 1990s, but on a gradual decline from the year 2000 until it rebounded in the late 2000s (see **Figure 4-4** in Chapter 4 for exact figure with timeline.)

In looking back at how the Japanese acquiescence to U.S. demands and pressures in the 1960s and 1970s came about, some notable bureaucratic factors come into consideration. The Japanese bureaucrats appear to have a constructive mindset that pressures from the outside can prompt changes in the Japanese state and society.<sup>143</sup> The political discouragement due to low likelihood of success in trade litigation in addition to the lack of bureaucratic resources and venues in the highly bureaucratic system of trade relief contributed to shaping the mindset of the Japanese trade bureaucrats. Under the Japanese bureaucratic system, suing as a final outcome is not strongly encouraged, and the existence of trade remedy tools at home ministries are not widely promoted to the industries that may face unfair trading acts at their home market by foreign competitors.<sup>144</sup> Instead, the ministries retain very close contact with the industries that it has traditionally maintained relationships with – mainly industries that contribute in large part to Japan’s overall GDP – and stays up-to-date on industrial performance. As will be further explained in Chapter 4, should the necessity of a trade remedy case arise in Japan, it is preferable that the industry resolves the issue by bilateral consultations prior to a trade remedy case. This way, Japan reduces its bureaucratic burdens of filing a case and

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<sup>143</sup> Furukawa, 2001. p.33. A former MOFA official, Furukawa states that the so-called ‘Japan Bashing’ by the United States is beneficial for Japan in undertaking new reforms into the future. A personal interview with Tanaka Hitoshi, also a former MOFA official agrees to this point.

<sup>144</sup> A METI official testifies to this point. Personal interview. December 5, 2013.

avoids diplomatic clashes, while all the while at work on trade remedy. This is a notable divergence from the recent argument that contends that Japan has been pursuing ‘aggressive legalism’ within the WTO dispute settlement system (Pekkanen, 2008). An examination of Japan’s trade disputes at home and abroad may highlight Japan’s active participation mainly as a third party in the WTO dispute settlement system - that is, when we are only looking at Japan - but a comparison of Japan with neighbors South Korea and China proves that it may not necessarily be the case Japan has come to pursue ‘aggressive legalism’. The following section on the trade remedy structures of each country will further explain how the strategic acquiescence in Japanese trade remedy mechanisms came about.

#### *South Korea’s Reciprocation*

The data on orders revoked before 1980 shows that the U.S. began to have AD/CVD investigations on South Korea since 1973, the first case being investigations on South Korea’s liquid sprayers. Countervailing duty investigations started in 1978, the first case being one on South Korean bicycle tires and tubes. In terms of industries that were of central concern in the investigations, the patterns of U.S. antidumping cases involving South Korean firms showed patterns similar to Japan’s, particularly involving sectors such as electronics, heavy industrial parts, steel, chemicals, semiconductors.<sup>145</sup> In addition, South Korea faced AD investigations in the areas of other assorted consumer

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<sup>145</sup> Bark argues that it was in the high price of the domestic market, and not the low price in the foreign market, that led to the imposition of U.S. antidumping restrictions on South Korean electronics. For South Korea’s consumer electronics industry, two characteristics of the industry make price discrepancies between domestic and international markets inevitable – an oligopolistic structure in the domestic market, and protection from imports. He contends that under such a circumstance of segmented markets, South Korean companies would naturally charge a higher markup at home than abroad to maximize profits (this still happens in South Korea today – e.g., Samsung Galaxy phones labeled with the highest prices at home).

products, such as bicycles (A-580-004), grand and upright pianos (A-580-405), and photo albums (A-580-501).

As much as South Korea continued to be a targeted country for AD investigations and imposition of duties, South Korea started to actively utilize its legal tools for launching AD investigations at home. **Table 3-3**, which shows the comparative number of cases that were initiated at home in China, Japan, South Korea, the U.S., and the European Union, since the establishment of the WTO, is clear evidence that South Korea's use of trade remedy measures shot up remarkably under the WTO system. As will be explained further in the following case study on South Korea, the use of trade remedy has been shaping the South Korean policy stance on trade remedy by reciprocity.

A notable diverging trend from the Japanese case of AD/CVD investigations would be that South Korea's assorted consumer products as well as heavy industrial goods were frequently under countervailing duty investigations. As demonstrated in **Table 3-1**, the total number of AD/CVD cases before the year 2000 are not as sizable in figures in comparison to Japan, but relatively high in the number of cases for CVD. For South Korea, the trend for CVD investigations continues after the 2000s, and whereas Japan has scored zero cases for CVDs after 2000, South Korea has faced six CVD investigations between 2000 and 2013.

The continuation of CVD investigations on South Korea after 2000 means that the U.S. found evidence that possible government subsidies continued to be distributed to certain South Korean industries in an effort to protect the industries. In this respect, while the data on orders revoked before 1980 do not tell us much due to the small number of cases,

the data on AD/CVD orders from the 1970s and onwards show that South Korea had followed similar paths of Japan with regard to antidumping cases, albeit in smaller numbers of cases, but not necessarily so in countervailing duty cases. Even after the establishment of the WTO system, targeted countries under CVD investigations were largely developing countries that had export-oriented structures of the economy that had strong state emphasis on fostering industries in general.<sup>146</sup>

### *China's Retaliation*

The very first antidumping investigation on imports from China was on food seasoning products from Ajinomoto China, a branch of the Japanese food company Ajinomoto in 1940. During the postwar years, the China branch of Ajinomoto was established in Shanghai in 1918 along with an office in Korea in 1931.<sup>147</sup> Other cases on China were on tung oil, or China wood oil (no case number given) in the years 1947 and 1948, which is drying oil obtained by pressing the seed from the nut of the tung tree. However, these cases failed to prove that they were selling at LTFV prices in the U.S. market. Countervailing duty investigations on China at the time were on feathers and other various products, but also did not result in levy of penalty tariffs. There was virtually no trade between China and the U.S. between 1949 and 1978.

As China gradually opened up its economy since Deng Xiaoping's economic reform in 1978, the frequencies of investigations on China increased. The initial antidumping investigation case is on natural menthol (A-570-100), which began in July of 1980.

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<sup>146</sup> Ko, Chun-sŏng, Hyŏk-ki Min, and Che-ho Yi. 2009. While South Korea is not necessarily categorized as a developing country by the IMF or the World Bank as of 2013, at the time of this writing, prior to the Lehman Shock of 2008, South Korea had yet to firmly establish itself as a strong exporting country.

<sup>147</sup> Corporate Guidance Ajinomoto, Inc. (<http://www.ajinomoto.com/guidance/business/china.html>)

Throughout the 1980s and 1990s, China continued to be on the U.S. radar for trade remedy investigations for many categories of agricultural goods, light consumer goods, from fresh garlic (A-570-831) to shopping carts (A-570-810), and stationery such as paper clips (A-570-826) and cased pencils (A-570-827).

One important aspect to consider is the growth of offshoring of Japanese and Korean companies to China from the late 1980s to the 1990s, after the bubble economy burst in Japan and the yen and won appreciated significantly, as firms sought to save production costs by taking advantage of cheap labor in China.<sup>148</sup> Production networks across East Asia were created and deepened by this effect. The effects of foreign companies' offshoring to China resulted in the production of cheap goods, and led to Chinese exports being subject to more antidumping investigations than South Korea even before 2000. Another trait of antidumping investigations on China is that the goods have continued to cover a wide range of exports, from agricultural goods such as frozen and canned warm water shrimp (A-570-893), to electronic goods such as desktop note counters and scanners (A-570-861), color television receivers (A-570-884), and heavy industrial products like carbon and alloy steel wire rod (A-570-902).

From the 2000s, China's official entry into the World Trade Organization brought about significant increases in the number of U.S. AD/CVD investigations on China. As noted in Table 3-1, China has faced a total of 129 U.S. AD/CVD investigations, of which 95 cases are on antidumping and 34 cases are on countervailing duty investigations. This total number is close to the number of cases that Japan had received prior to 2000,

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<sup>148</sup> The trend continues today despite many Chinese SOEs that have come into the spotlight with their performance in the world economy after the WTO accession.

although the proportion of countervailing duty and antidumping cases differ. Unlike Japan, which did not face multiple countervailing duty investigations by the U.S., China continued to score high numbers in countervailing duty investigations, largely owing to the state's strategic support of certain industries. The products investigated ranged broadly, from frozen warm water shrimp (C-570-988) to hardwood and decorative plywood (C-570-986, C-570-987), coated sheet paper (C-570-906, also placed under AD) and steel products (C-570-974). As will be shown in the case study section of this chapter and Chapter 4, China has developed its own institutional mechanism and policy stance of retaliation in dealing with wide scale trade remedy investigations by the United States, both in terms of domestic trade remedy and also trade disputes at the international level in the WTO DSB.

### **Japan (1955-Present)**

#### *Japan's Legal Foundations for Trade Remedy*

The legal foundations for Japan's trade remedies are based on three components: the Customs Tariff Law, Cabinet Orders relating to AD/CVD and Safeguards, and Regulations /Guidelines relating to AD/CVD and Safeguards. The legal foundations for Japanese trade remedy of antidumping, countervailing duty, and safeguards are embodied in the GATT Article VI, the Antidumping Agreement of 1998, and domestic laws.<sup>149</sup> The domestic laws are mainly Cabinet Orders (国内関係法令), and specific guidelines on

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<sup>149</sup> 関連国際協定・国内法令等  
([http://www.meti.go.jp/policy/external\\_economy/trade\\_control/boekikanri/trade-remedy/ad.html](http://www.meti.go.jp/policy/external_economy/trade_control/boekikanri/trade-remedy/ad.html))

antidumping (関税及び貿易に関する一般協定及びダンピング防止協定<sup>150</sup>), emergency duty for safeguards (貨物の輸入の増加に際しての緊急の措置に関する手続等についてのガイドラインの制定), and domestic law on countervailing duty (関税定率法第7条、相殺関税に関する政令). In contrast with the cases of South Korea or China, Japan does not have a specific law with the objective of scrutinizing unfair trade acts, and the domestic laws that provide the legal grounds for trade remedy are placed within and not beyond the legal concepts and borderlines of the WTO agreements and rules. As opposed to Japan, both China and South Korea have become one of very few jurisdictions in the world after the U.S. and the EU to implement retaliatory measures in trade remedy. Japan does not see a need for such strong measures through domestic legislation. The difference between China and South Korea is in the degree of implementation – while South Korea tends to utilize it as a reciprocating tool, China has the domestic law strongly enforced against trade remedy actions from its trading partners to the level of retaliation.

**Table 3-5. Japanese Legal Structure for Trade Remedies**

	Antidumping	Countervailing Duty	Safeguard	
			Duty	Import Quotas
Law	Customs Tariff Law (Article 8)	Customs Tariff Law (Article 7)	Customs Tariff Law (Article 9)	Foreign Exchange and Foreign Trade Control Law (Article 52)
Cabinet Order	Cabinet Order relating to Antidumping Duty	Cabinet Order relating to Countervailing Duty	Cabinet Order concerning Emergency Duty	Import Trade Control Order (Article 3)

<sup>150</sup> Guidelines for Petitioning for Antidumping Tariff Levy (不当廉売関税に関する手続等に着いてのガイドライン), the Ministry of Finance (MOF), the Ministry of Health, Labour and Welfare (MHLW), the Ministry of Agriculture, Forestry and Fisheries (MAFF), the Ministry of Economy, Trade, and Industry (METI), and the Ministry of Land, Infrastructure, Transport, and Tourism (MLITT), April 2011.

Regulations / Guidelines	Guidelines for Procedures Relating to Antidumping Duty	Guidelines for Procedures Relating to Countervailing Duty	Guidelines for Procedures Relating to Emergency Duty, etc.	Regulations to Govern Emergency Measures to be taken in Response to an Increase in the Importation of Goods
				Guidelines for Procedures, etc. Relating to Emergency Measures to be taken in Response to an increase in the Importation of Goods

Source: Office for Trade Remedy Investigations, Ministry of Economy, Trade, and Industry, Japan, 2011

### *Japan's Trade Remedy Structure: The Difficulties of Petitioning*

The Japanese AD/CVD Investigating Authority is not assigned to a specific institution. The tasks are divided among the Ministry of Finance (MOF), the Ministry of Economy, Trade and Industry (METI) – for example, if and when an agricultural product is of concern, the Ministry of Agriculture, Forestry, and Fisheries (MAFF) or another ministry directly relevant to the petitioned product area investigates the claim. Within the METI and the MOF, METI's Office for Trade Remedy Investigations and MOF's Office for Trade Remedy Affairs are in charge of the investigations. METI serves as the headquarters and database for Japan's AD/CVD investigation, with the Trade Remedy Investigation Bureau (*Keizaisangōshō bōeki kyūsai sochi*) placed directly under METI. For AD/CVD duty levy, the heads of MOF, METI, and the relevant ministry consult with one another, and the METI Trade Bureau (貿易局貿易調査課) and MOF Customs Tariff Bureau (関税局企画課) also get involved. For safeguards, since the case may culminate in a trade conflict at the national level, the Minister of Finance cautiously decides on policy actions through consultations with other heads of METI or relevant ministries via the Customs Tariff Council. Industries that are facing material injury due to unfair trade

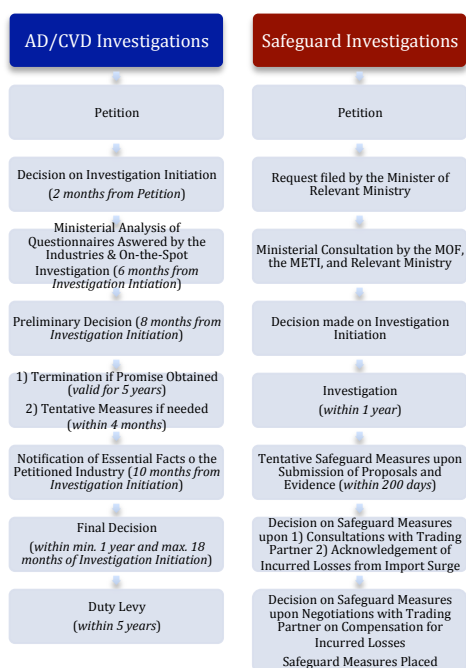
practices by competing foreign firms can bring their petitions to the METI and the MOF, and the first step is to address the concerns by starting with a legal consultation with the ministry prior to the investigation. However, unlike in the cases of China and South Korea, litigation costs that are borne beyond the consultation stage are primarily the industries' responsibility.

While the legal foundations create a framework for the use of trade remedy measures in Japan, despite the fair amount of petitions and cases brought to the home ministries, the number of actual AD/CVD orders issued after investigations toward the final stage that is actively pursued by the ministries of Japan is very minimal compared to the cases of South Korea and China. This trend could be largely attributed to several institutional factors: first, the Japanese ministries are not equipped with the financial resources for legal backup to support all petitions, and thus do not place priority on trade remedy tasks amongst their other tasks and missions, nor do they put efforts into promoting the existence of trade remedy mechanisms; second, from the industry perspective, the administrative procedures involving consensus of two highly bureaucratic different ministries in order to process a petition toward investigation is certainly not an easy task. Having both the METI and MOF on board for trade remedy investigations require intra-ministerial coordination.

The lack of ministerial backup for trade remedy is what really explains the Japanese case from the Chinese and South Korean cases. The institutional initiatives and bureaucratic motivations for trade remedy are not as strong in Japan as in China or South Korea. Beyond the consultation stage prior to initiation of investigation in which legal

advising is provided by the ministries, but beyond preliminary investigations, there are also burdens of high legal fees that will incur which will fall on the shoulders of the petitioner because they are not supported by the government.<sup>151</sup> The cost for litigation may not be a big burden for large, main enterprises that drive Japanese economic growth, but it is an overwhelming burden for small and medium-sized industries that are grappling with losses due to unfair trade rule violations by their competing foreign firms.

**Figure 3-4. Japanese Trade Remedy Procedures & Time Frames Flowcharts**



Source: Office for Trade Remedy Investigations, Ministry of Economy, Trade, and Industry, Japan

The length of the procedure is at the average level in comparison to the cases of South Korea and China. But within the Japanese bureaucracy, in the absence of priority and

<sup>151</sup> Amongst the frequently asked questions on the METI Trade Remedy Bureau page are on expected fees of petitions and investigations. The METI answers that in general, fees for hiring a lawyer and conducting investigations will result in fees that the industry will be expected to prepare. [Is this unusual? I have the impression that US law firms that do trade law are hideously expensive.] However, the petition itself and the consultation stages will not cause any financial burden on the petitioning industry. ([http://www.meti.go.jp/policy/external\\_economy/trade\\_control/boekikanri/trade-remedy/qa.html](http://www.meti.go.jp/policy/external_economy/trade_control/boekikanri/trade-remedy/qa.html))

emphasis on a certain case at the ministerial level that supports and pushes for the petition toward investigation, the procedure could be subject to delays or rejection. In general, a Japanese petition for an antidumping duty investigation takes 2 months to be processed, and once the investigation authority decides to initiate an investigation, the process takes about 12 months to reach final determination on whether or not to impose antidumping duty.<sup>152</sup> Prior to applications for investigations, a consultation process is required, coupled with the examination of products under investigation and of target countries. Once the investigation is initiated by the MOF and the METI, it is reported to the Customs Tariff Council, and the Cabinet ultimately approves the preliminary and final determinations deriving from investigation results.<sup>153</sup>

**Table 3-6. Japanese Decision Making Process of AD/CVD Cases**

<b>Stages</b>	<b>Required Actions</b>
<b>Before Applications (Petitions)</b>	Consultation with industries about trade remedies and an application Examination of a product under investigation Examination of target countries Pre-examination of application documents (standing, Dumping margins data, injury data)
<b>For Initiation of Investigation</b>	Examination of application documents within the investigating authorities Approval for Initiation of Investigation within the MOF & METI, respectively Report to the Customs Tariff Council about the initiation
<b>For Preliminary Determination / Provisional Measures</b>	Analyzing and verifying replies to questionnaires within the investigating authority Approval for the Preliminary Determination / the Provisional Measure within the MOF & METI, respectively Approval for the Provisional Measure by the Customs Tariff Council Approval for the Provisional Measure by the Cabinet
<b>For Final Determination / Definitive Measures</b>	Examination of Comments from the related parties within the investigating authority Approval for the Final Determination / the Definitive Measure within MOF & METI, respectively Approval for the Definitive Measure by the Customs Tariff Council Approval for the Definitive Measure by the Cabinet

*Source: Office for Trade Remedy Investigations, Ministry of Economy, Trade, and Industry, Japan*

### **South Korea (1986-Present)**

#### *South Korea's Legal Foundations for Trade Remedy*

<sup>152</sup> Guidelines for the Imposition of Antidumping Tariff Levy (不当廉売関税 (アンチダンピング関税) を課することを求める書面の作成の手引き), the Ministry of Finance (MOF) and the Ministry of Economy, the Ministry of Economy, Trade, and Industry (METI), Japan, April 2011.

<sup>153</sup> *Trade Remedy Situations in Japan*, Office for Trade Remedy Investigations, Ministry of Economy, Trade and Industry, 2011.

In South Korea, AD/CVD and Safeguard investigations are carried out based on the legal foundations of the Customs Tariff Law (관세법, revised in 1967) and the Foreign Trade Law (대외무역법, enacted in 1986). In addition to the two main pillars of laws, South Korea has also implemented a set of laws that not many other countries in the world have implemented - the Law on the Investigation of Unfair Trade and Industrial Injury Remedy (불공정무역행위조사 및 산업피해구제에 관한 법률), which went into force since February 8, 2006.<sup>154</sup> The law on unfair trade is equivalent to Section 301 of the Trade Act of 1974 of the United States, which allows for retaliatory measures in trade remedy, and the Trade Barriers Regulation (TBR) of the European Union. Prior to the implementation of the law, a senior board member of the Korea Trade Commission was quoted as saying that South Korea's implementation would be closer to the EU's Trade Barrier Regulation (TBR) in concept. South Korea was the fourth jurisdiction in the world to implement such a law after the U.S., the EU, and China (China implemented specific laws of the same sort in 2005, based on amendments of its interim rules drafted in 2002. The section on China later in this chapter will provide more details on how China implemented a similar law.)<sup>155</sup>

While the WTO does not provide a specific definition of 'unfair trade', the contents of the South Korean law are drafted in such a way that unfair trade does not obstruct the growth of domestic industries, and that international trade rules stipulated in the

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<sup>154</sup> Executive Orders and Revised Presidential Orders on the Investigation of Unfair Trade Acts and Remedies for Industrial Damages (불공정무역행위 조사 및 산업피해구제에 관한 법률[시행 2012.3.15] [대통령령 제 23339 호, 2011.12.2, 일부개정] 시행령, 산업통상자원부 불공정무역조사팀)

<sup>155</sup> '한국판 301 조 이달부터 시행' (A Korean Version of Section 301 Implemented from this Month), Kbiz, February 13, 2006. (<http://news.kbiz.or.kr/news/articleView.html?idxno=10746>)

Marrakesh Agreement are not violated in the domestic market. The law states three major patterns of unfair trade – violation of intellectual property rights, violations of rules of origin, and impediments to export-import order. This law expands the scope and definition of trade remedy actions from simply adhering to the classic cases of AD/CVD and safeguard to incorporate unfair trade acts that are also punishable under South Korean law.

**Table 3-7. South Korean Legal Structure for Trade Remedies**

	Antidumping Duty	Countervailing Duty	Safeguard	Unfair International Trade Practices Investigation (Since 2006)
Law	Customs Tariff Law (Articles 51-56) Trade Remedy Law	Customs Tariff Law (Articles 57-63)	Customs Tariff Law Trade Remedy Law (Articles 15-22)	Trade Remedy Law (Articles 4-14)

*Source: Korea Trade Commission Portal ([http://ktc.go.kr/repag/sub\\_01\\_11.jsp?m=m11](http://ktc.go.kr/repag/sub_01_11.jsp?m=m11))*

After experiencing turbulent decades of trade conflicts in the 1980s and 1990s, South Korea took the steps to put in place strong legal measures for trade remedy. Against the backdrop of South Korea's increasing trade dependency ratio and proliferation of bilateral trade agreements, South Korea saw that it must take initiative to place additional legal measures to protect its industries. It is also worth noting that in South Korea, the laws on trade remedy are actively revised and reinforced year by year. It is quite clear in the directions of policy that South Korea felt the urge to firmly establish the legal and policy mechanisms for trade remedy. The ministerial decision to enforce the law in 2006 was made by the former Ministry of Commerce Industry and Energy, which is now the Ministry of Trade, Industry, and Energy (MOTIE).

The Korea Trade Commission (KTC) administers the implementation of the law. Chung Joon-seok, member of the KTC, was quoted as saying that as South Korea increases the number of free trade agreements with its trading partners, it has faced the

necessity to take legal actions to protect the domestic industrial interests from unfair or discriminative trading practices or policies that are customary.<sup>156</sup> The KTC holds authority for South Korea's trade remedy investigations. The KTC's history began at the apex of South Korea's trade confrontations with major trading partners including the U.S., Canada, and European states. The KTC was first established under the Ministry of Commerce in July 1987, and since then has been moved around ministries twice amid governmental bureau restructuring, which is a reflection of tumultuous political transitions that South Korea has had and has been a hindrance to establishing the system in an efficient manner. South Korea followed the example of the U.S. case (see p.6 of this chapter) in relegating the tasks for AD/CVD investigations to the Ministry of Commerce from the Treasury Department in December 1993, and since then, systematic preparations for legislation for effective trade remedy actions took place.<sup>157</sup> With the KTC as the investigative authority placed under the Ministry of Commerce, which is inherently inclined toward policies in favor of protecting domestic industries, the AD/CVD investigations in South Korea started to take off.<sup>158</sup> The relegation of trade remedy tasks

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<sup>156</sup> *Ibid.*

<sup>157</sup> Later on the Korea Trade Commission belonged to the Ministry of Commerce Industry and Energy in 1998 (of which it was a restructuring of the Department of Commerce in which the commerce related tasks were transferred to the Ministry of Foreign Affairs and Trade and the Ministry of Commerce Industry and Energy). The changing titles of ministries and transfer of tasks around ministries are prevalent upon the launch of new administrations upon presidential elections is prevalent in South Korea. Most recently, it has been transferred from the Ministry of Knowledge Economy under the Lee Myung-bak Administration to the newly established Ministry of Trade, Industry and Energy (MTIE) launched on March 23, 2013 by the new Park Geun-hye Administration.

<sup>158</sup> Contrary to the rigidity that is often found in the bureaucratic system, one dynamic feature that is quite interesting and apparent in South Korea's bureaucracy is the rapidity in the ways of adopting foreign systems. The South Korean bureaucracy frequently contrasts its policy and system with those of other developed nations (the U.S., EU, and Japan), and if an agenda appears to be of crucial necessity to improving the South Korean system, a bill is pushed forward. However, the consequences of such quick policy adoptions based on foreign experiences are not always appropriate for the South Korean case.

to the KTC, an investigative authority focusing on its main duties of trade remedy in the South Korean case, is a big departure from what we see the Japanese case, in which the MOF still bears partial responsibility and authority with the METI on decisions of AD/CVD investigation launches and procedures, in the absence of a separate bureaucratic entity as an investigative authority for trade remedy.

The Office of Trade Investigation at the KTC is divided into four task teams: Trade Remedy Policy, Industrial Damages Investigation, Dumping Investigations, and Unfair Trade Investigations. While the task teams are primarily managed by government officials, the Commission's head members include academics, legal experts and economists from research institutes and major law firms, and section chiefs of relevant ministries of which a large number have pursued studies and degrees in law or economics in the U.S. and/or Europe. This means that in the process of decision-making, relevant expertise outside the realms of the ministry is often sought. Moreover, the KTC's reach-out activities of promoting trade remedy policies (i.e., academic seminars, calls for papers, publications, forum launches, and trade remedy case analysis contests by college students) are quite noticeable and approachable to the general public, which is a visible contrast with the Japanese case.

Notably, the biggest divergence from the Japanese case that may lead to larger numbers of petitions in the South Korean system, is in the financial support for legal consultation concerning trade remedy from both private and public sectors. For petitioning industries, the International Trade Office of the Korea Federation of SMEs (중소기업중앙회) provides up to 70% of total fees incurred (limit to 70,000,000 KRW,

which is roughly 66,000 USD) toward preparations of petitions (i.e., fees for hiring lawyers, patent attorneys, accountants). For industries that are charged with dumping or safeguard allegations, the Trade Cooperation Office of the Korea International Trade Association (KITA) sponsors up to 50% of fees incurred for hiring lawyers for legal consultations (limit to 50,000,000 KRW, which is roughly 47,000 USD).<sup>159</sup> SME CEOs provide testimonies on the KTC website and promotion brochures that they were able to overcome their hardships in the industries when faced with dumping or other unfair trade activities by foreign competitors in the domestic market, and that with the administrative help, courage and support from the KTC were they able to successfully file in a petition and receive costs for damages or place restrictions on foreign imports.

As in **Figure 3-5**, in the South Korean case, the decision on whether to initiate an investigation is made within 2 months, and preliminary decisions take 3 months from launching date of investigation. Final decisions on duty levy take up to one year following the preliminary decisions, depending on the degree of importance of the industry and product being investigated. If duties are to be deployed after investigations, the Minister of Strategy and Finance levies the duties upon final submission of the request by the Commission.<sup>160</sup> The database on South Korea's AD/CVD domestic investigations are accessible via the Korea Trade Commission website (*Muyeog-Wiwonhoe*).<sup>161</sup> The data comprises of all AD/CVD, Safeguard, Unfair Trade data from 1987 to 2012 and lists are provided by country, by product, and trading act.

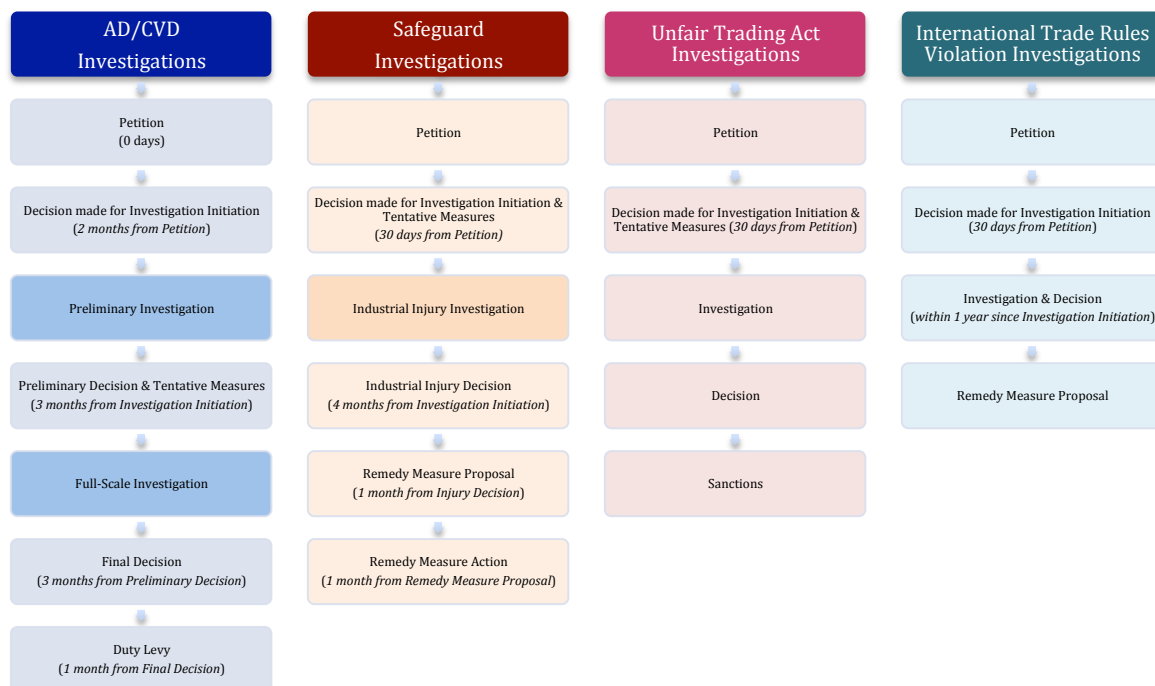
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<sup>159</sup> The Korea Trade Commission Brochure, June 2012.

<sup>160</sup> Korea Trade Commission ([http://www.ktc.go.kr/sub\\_frame.jsp?link\\_menu\\_id=05](http://www.ktc.go.kr/sub_frame.jsp?link_menu_id=05))

<sup>161</sup> Details on the case investigations require Korean national identity number input for log-in.

**Figure 3-5. South Korean Trade Remedy Procedures & Time Frames Flowcharts**



Source: Korea Trade Commission Promotion Data  
[http://www.ktc.go.kr/sub\\_frame.jsp?link\\_menu\\_id=0601](http://www.ktc.go.kr/sub_frame.jsp?link_menu_id=0601)

### China (1994-Present)

#### *China's Legal Foundations for Trade Remedy*

Amongst the three countries of Japan, South Korea, and China, it is China that possesses, implements, and enforces the strongest laws for trade remedy and investigation procedures. There are two major strands of China's legal foundations for

trade remedy (see Table 3-10) - first, the Antidumping (反倾销条例: *fǎn qīngxiāo tiáolì*), Countervailing duty (反补贴条例: *fǎn bǔtiē tiáolì*), and Safeguard Regulations (保障措施条例: *bǎozhàng cuòshī tiáolì*) of the PRC; second, the Foreign Trade Law, which is the main source of the power China wields in trade remedy mechanisms today. China's legal foundations on foreign trade began in the Foreign Trade Law (对外贸易法: *duìwài mào yì fǎ*) of 1994. But the actual developments of strong legal rules for trade remedy did not occur until China's accession to the WTO and onwards. Since 2005, China has moreover been equipped with the Foreign Trade Barriers Investigation Rules (对外贸易壁垒调查规则: *duìwài mào yì bìlěi diàochá guīzé*), which has become the main source of retaliatory measures in China's trade remedy system.

China's WTO entry and the negotiation process toward WTO membership gave impetus to reinforced legal mechanisms in domestic law. In 2001, the initial laws written on China's AD/CVD and Safeguard investigations and duty levy remained premature in terms of legal development, but were revised in 2004 for stronger enforcement.<sup>162</sup> After joining the WTO, China was immediately faced with potential threats to its domestic industries as a result of its trading relations with other nations. Retaining a developing country status and enjoying a non-market economy status, China would have 15 years from its WTO accession in 2001 in which to defer certain requirements of the WTO. Nonetheless, the legal features of China's trade remedy system are strikingly powerful

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<sup>162</sup> Gao, 2012.

for a developing economy.<sup>163</sup> As in the South Korean case, China's Foreign Trade Law also enables retaliatory actions and provides the grounds for legal enforcement as the Section 301 of the Trade Act of 1974 does for the U.S and the Trade Barrier Restrictions of the EU. In practice, China has taken as hard a line in implementation of the law as the U.S. does with Section 301, while the South Korean implementation of the law on Unfair Trade has been closer to the case of the EU's TBR, focusing mainly on tackling discriminatory treatment and combatting potential injuries arising from unfair trade, rather than taking retaliatory measures.

It is worth noting the procedure that led to the promulgation of the Foreign Trade Barriers Investigation Rules of 2005. At first, China relied on the Interim Rules on Foreign Trade Barriers Investigation, which was promulgated in 2002. Faced with a surge of AD/CVD investigations from its trading partners after the WTO accession, the Ministry of Commerce prepared a preliminary draft of revision on October 28, 2004, and sought suggestions from the public on the draft until November 10 of the same year. The revised draft of the Foreign Trade Barriers Investigation Rules was announced on February 2, 2005 and went into effect on March 1, 2005.<sup>164</sup> In the process, an article was lifted from the preliminary draft, which stated that petitioners may file an administrative lawsuit against the MOC should they not agree with the details of the administrative conclusions of the trade remedy procedure regarding their petitions drawn out by the

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<sup>163</sup> Under the Sino-U.S. Agreement in 1999, the U.S. will not regard China as a Market Economy until the year 2016. India is often used as a surrogate comparative tool to analyze dumping margins, and it is also a rare developing economy scores high numbers of AD/CVD investigation initiations and frequently addresses cases of its trade disputes in the WTO dispute settlement body.

<sup>164</sup> The People's Daily, '商务部: 中国将出台对外贸易壁垒调查规则'(Ministry of Commerce: China will introduce Foreign Trade Barriers Investigation Rules) <http://politics.people.com.cn/GB/1027/3203558.html>

Bureau of Fair Trade for Imports and Exports of the MOC.<sup>165</sup> This means that the MOC sought to retain full authority over its decisions and to prevent possible overturns of its decision on trade remedy. The final draft also made it clear that the MOC regards both injuries on Chinese exports and imports as subject to the Rules.

What empowers the Foreign Trade Barriers Investigation Rules with potential retaliatory measures is the content of the articles on dispute settlement system. According to the Rules, the MOC is entitled to first and foremost hold bilateral consultations with a trading partner regarding its affected industry and/or product. Second, if the consultations do not lead to an understanding, the MOC may seek to resolve the matter through multilateral tools – by the WTO Dispute Settlement Body. Third, in the case that the specific trading partner does not comply with the decisions made in bilateral consultations or the WTO, the MOC may impose measures that are deemed appropriate for resolving the dispute. This very part obliges the MOC to take further measures beyond its capability as a WTO member in order to protect its industries at home.

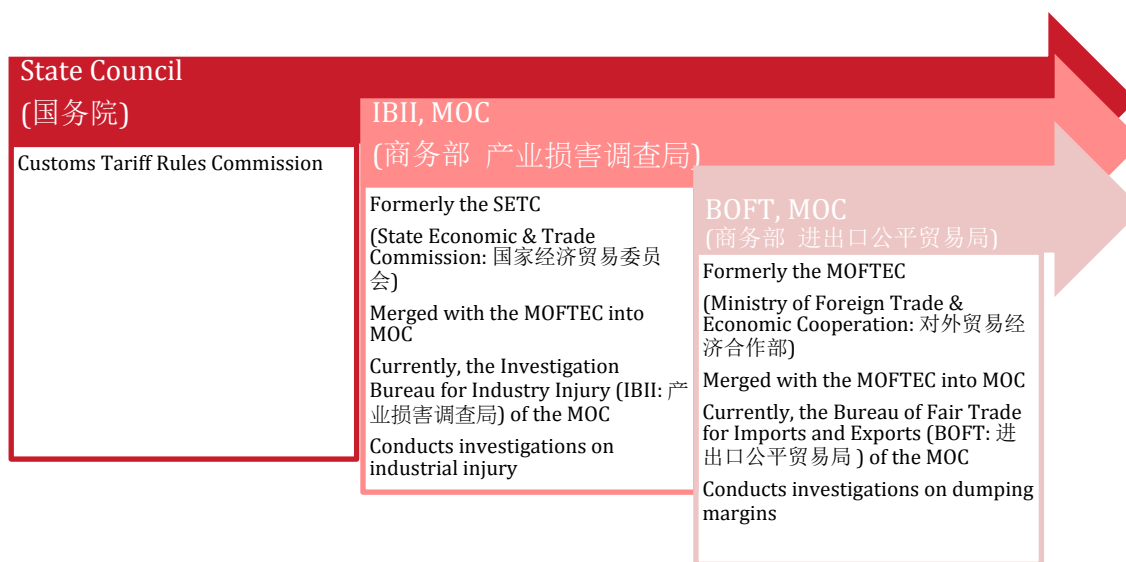
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<sup>165</sup> The initial draft is no longer available on the MOC website, and only the revised draft remains. Article 36 of the revised draft states that the interpretation of these Rules should be vested in the Ministry of Commerce. <http://www.mofcom.gov.cn/article/b/c/200503/20050300023641.shtml>

**Table 3-8. Chinese Legal Structure for Trade Remedies**

Trade Remedy	AD/CVD	Safeguard	Unfair Trade
Law Implementation in Chronology	Antidumping/Countervailing Duty Regulations promulgated (2001)	Safeguard Regulations promulgated (2001)	
	<b>WTO Accession (December 2001)</b>		
	Antidumping/Countervailing Duty Regulations amended (2004.03.31)	Safeguard Regulations amended (2004.03.31)	Interim Rules on Foreign Trade Barriers Investigation Promulgated (2002.09.18) In effect (2002.11.01)
Promulgation of the Revised Foreign Trade Law (2004.04.06)	Promulgation of the Revised Foreign Trade Law (2004.04.06)	Foreign Trade Barriers Investigation Rules Promulgated (2005.02.02) In effect (2005.03.01)	

Source: By author based on documents and statements by the MOC

**Figure 3-6. China's Investigating Authorities and Trade Remedy Process**

Source: By author

### *China's Trade Remedy System: Soliciting Petitions and Exercising Authority*

In the year of 2002, the predecessor of the MOC – the Ministry of Foreign Trade & Economic Cooperation: 对外贸易经济合作部 – announced the Guidelines on the Collection of Information on Trade Barriers (贸易投资壁垒信息收集指南), listing common everyday patterns of trade barriers divided into tariff barriers and non-tariff

barriers and soliciting petitions. The guidelines were disseminated to provincial governments in China to solicit petitions from industries experiencing trade barriers. Today, the guideline is still used as a manual for petitions by domestic industries and the MOC in processing the petitions. As indicated in **Table 3-8**, the MOC operates two units - the Investigation Bureau for Industry Injury (IBII), which conducts investigations on industrial injury, and the Bureau of Fair Trade for Imports and Exports (BOFT), which conducts investigations on the dumping margins. The two bureaus are the main instrumental organs of the MOC that work closely with each other on trade remedy investigations in China.

There are some factors that distinguish China's procedures of petitioning for trade relief and its processes from those of Japan and South Korea: first, under the authoritarian rule, the MOC relies not only on petitions but is also entitled to start its own investigations of trade remedy should it find it necessary; second, the guidelines do not provide a clear definition on the eligibility of the petitioner as long as they are domestic industry persons, nor on the exact required information on the industry's market shares. Rather, evidence on material injury is sought in paper, and the widespread callout by the MOC for petitions solicits and facilitate as many possible petitions as possible within the wide spectrum of China's trade.<sup>166</sup> Within 2 months of petitioning, the MOC decides whether it will start investigations or not, and the petitioner may withdraw within this

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<sup>166</sup> Will Turner, 'Understanding and Preparing for Chinese Trade Remedy Cases', *China Business Review*, Magazine of the U.S.-China Business Council (USCBC), April 1, 2012. The author, who was manager of government affairs at the USCBC, notes that Chinese industry petitions are not publicly available when filed and that cases are not processed in a standard timeline. In other words, the MOC processes petitions on their own terms. <http://www.chinabusinessreview.com/understanding-and-preparing-for-chinese-trade-remedy-cases/>

period. However, once the MOC decides to start investigations, it leaves the hands of the petitioner completely and withdrawal of the case is not permitted. In the course of the investigations, the MOC upon need may seek advising from relevant bureaus of the State Council, experts on trade, and academics. The MOC is also entitled to use methods of surveys and public hearings to facilitate the understanding of the matters of the investigation. Finally, within 1 year of the investigation launch, final decisions are drawn at the sole discretion of the MOC.

In addition to its efforts in carrying out trade remedy investigations, the MOC has since 2002 been publishing the Foreign Market Access Report (国别贸易投资环境报告), which analyzes report on trade and investment environments by country and by year. The database for China's AD/CVD cases are accessible via the China Trade Remedy Information Network (中国贸易救济信息网 *Zhōngguó màoyì jiùjì xīnxi wǎng*) under the Ministry of Commerce and the Department of Information Technology.<sup>167</sup> However, the most reliable and approachable source is the WTO archives of investigations by country, to which China must also submit reports on its AD/CVD and safeguard investigations on a semi-annual basis.

### **Responses of Japan, South Korea, and China to U.S. Trade Remedy Measures**

In retrospect, responses to U.S. trade remedy measures have not been uniform in the three countries owing to 1) the legal foundations that provide the grounds for trade

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<sup>167</sup> At current stage, it is impossible to obtain data of cases through the MOC archive route, as new registered users to the website are not authorized to view any content even upon log-in. Because the system is not open to new users, in order to assess U.S.-China AD/CVD cases, one must rely on the WTO document archives on AD/CVD practices of China, and figure out specific details via searches of keywords on Chinese webpages (for example, *fǎn qīng xiāo* 反倾销 antidumping).

remedy reactions and 2) the different actions and policymaking of the ministries emanating from the sources of domestic laws. Japan's entry to the GATT in 1955 and its high-speed industrialization brought home a surge of AD/CVD investigations by U.S. authorities. South Korea faced a similar course after joining the GATT in 1967. China's peak of being targeted for AD/CVD investigations came after its accession to the WTO in 2001.

**Table 3-9. Current Antidumping and Countervailing Duty Orders in place (as of September 23, 2013)**

Country	AD	CVD	Grand Total
China	94	27	121
India	15	7	22
Taiwan	18		18
Korea	12	3	15
Japan	13		13
Brazil	8	2	10
Indonesia	7	3	10
Mexico	9		9
Vietnam	6	2	8
Thailand	6	1	7

*Source: WTO*

In the cases of the three countries of Northeast Asia, despite having the similarities of the stages in economic development and undergoing the stages of AD/CVD cases at different time periods, the country responses with regard to U.S. AD/CVD cases and each country's pathways toward developing a trade remedy mechanism were clearly different. In the absence of a law strictly focusing on trade remedy, Japan has strategically acquiesced to foreign pressures for trade remedy by building a mechanism that prefers consultations prior to resorting to trade remedy measures, in the understanding that it will be able to focus on strategic areas. The practice has led to Japan's decision not to fortify

its trade remedy mechanisms in comparison to its neighbors, but rather pushed Japan toward updating its standards adhering to the changes of global trade regulations and norms.

Meanwhile, with the absolute increase in free trade agreements outside the WTO framework since 2006, South Korea has faced the need for a stronger mechanism for trade remedy and has put its need into legislation and policy implementation. It has been reciprocating in response to foreign pressures, albeit the smaller degree of foreign pressures it has faced compared to Japan and China in absolute terms. It has adopted a trade remedy structure and the legal mechanisms that support active trade remedy policies by which it actively protects its industries for better performance at home and abroad. It reaches out to the public to promote its trade remedy mechanisms in place and uses the mechanism as a defensive tool.

Lastly, upon entering the global economy, China immediately built a strong trade remedy system that embarks on investigations at exponentially increasing numbers. In simple terms, China's trade remedy system was built on the need to address numerous concerns from its trading partners, which are in large scales of complaints. Currently, China's practices of dumping and government subsidy provision to industries are easily detected and it trades widely with countries all over the world, making China all the more vulnerable to AD/CVD investigations.

Amongst the three countries of East Asia, China's and South Korea's trade remedy systems are stronger than Japan's, but while China implements a trade remedy system is both defensive and offensive in nature, South Korea mainly seeks for defensive perusal of

its trade remedy system. While contentions that Japan has been building aggressive legalism in the WTO may be feasible based on Japan's growing participation in the WTO dispute settlement mechanism (especially as third party), this chapter's analysis of Japan's trade remedy system shows that due to its institutional limits borne by strategic policy choice, Japan is less willing than South Korea or China to bolster its trade remedy.

## CHAPTER FOUR

Trade Wars Continued:  
East Asian Responses to U.S. Protectionist Actions in the WTO,  
1995-2013

### **The WTO as an International Platform for Trade Wars**

While the three Northeast Asian countries have firmly established trade remedy measures under their own jurisdictions, as explained in Chapter 3, they also have another venue for resolving trade disputes at the international level – in the Dispute Settlement Body of the World Trade Organization. After the negotiations in the Uruguay Round were completed in 1994, the World Trade Organization was established in 1995, pursuant to the Marrakesh Agreement. In addition to a new set of rules in the global trade regime, the establishment of the WTO Dispute Settlement Body (DSB) was by far the most significant update to the previous GATT system. Under GATT, countries could pursue trade remedy mechanisms in a unilateral manner, but a solid mechanism of dispute settlement and resolution process was absent and the methods of enforcement were not systematic. Today, the World Trade Organization oversees global trade with legally binding force.

Over the past twenty years, the WTO dispute settlement body has evolved into a full-fledged institution that has the power to compel and encourages its member states to comply with global standards in trading goods and services. During the negotiation process that led to the establishment of the toward the establishment WTO, U.S. policymakers expressed concerns that the legally binding force exercised by the WTO DSB could restrict U.S. capabilities to exercise unilateral actions and initiatives for trade remedy via legal provisions such as the Section 301, and also consensus on whether the

system would actually serve U.S. interests.<sup>168</sup> In the startup process, advanced economies were in a favorable position, and in the beginning, they dominated the DSB system by targeting its trading partners. A large number of countries that brought cases to the WTO in the initial phase were mainly from the developed world, particularly the U.S. and the European Union. However, as time progressed, more and more developing economies were able to adapt to the WTO DSB mechanism and would succeed in defending their interests. Today, it is not difficult to notice the increasing number of cases filed by emerging market economies like Brazil, China, and India. Other least developed countries of the Americas and Africa also pursue the DSB to their advantage by actively engaging in the dispute settlement system as a complainant, respondent, or third party to dispute settlement cases at the WTO. Despite the stalemate of the Doha Development Agenda (DDA), the WTO DSB remains a very concrete, legally binding, and powerful tool for both developing and developed countries to address their issues concerning trade as members of the WTO.

### **The Point of Investigation**

There are two key research questions to be investigated in this chapter. The first is on WTO dispute initiation from the U.S. perspective, and the role of U.S. trade deficits in U.S. WTO dispute initiations. Many scholars in the field of IPE and WTO studies have sought to explain why countries sue in the WTO (Davis, 2012; Kim, 2010; Pekkanen, 2008; Iida, 2006; Davis, 2003). Before unraveling the domestic politics of WTO dispute

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<sup>168</sup> The amended U.S. legal provisions under the Section 301 came under scrutiny when the EU filed for a case in the DSB (DS152, *United States — Sections 301–310 of the Trade Act 1974*) in asserting that the Section 301 is inconsistent with WTO rules.  
[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds152\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds152_e.htm)

initiation in each of the three countries, this chapter first seeks to identify how big a role the accumulation of U.S. bilateral trade deficits, specifically with China, Japan, and South Korea, could affect its actual decisions to file a dispute in the WTO. Additionally, the first part of the chapter seeks to answer why of all the trade remedy cases that the USTR deals with, only certain cases have been taken to the WTO.

The second question to be investigated is the variance in the responses to U.S. dispute initiations by the three countries, and their behavior patterns in the WTO as complainant, respondent, and observer. While other scholars have provided some explanations as to why countries sue in the WTO in general, my analysis here seeks to find an answer to the differing responses by the three countries in the context of the structures of decision making at home with regard to country responses or dispute initiation in the WTO. To investigate this question, the second section of the chapter will investigate the domestic institutional provisions and procedures for each of the countries to initiate or respond to a WTO trade dispute, using case studies as examples. As a preview, some of the very important sub-questions to be answered in the qualitative section are the following: what makes China's participation in the WTO so distinct from those of Japan's or South Korea's? What are the administrative procedures toward a case filing in each country and what, if at all, are the political motivations, economic costs toward trade dispute initiations in the three countries? For instance, are there diplomatic, budgetary, or industrial constraints toward a case filing or responding? On what grounds does each country initiate a case, and where do they obtain their legal expertise and support?

In addition to the quantitative analysis in the first section, answering the qualitative questions in the second section will lead us to achieving the two main goals of the chapter, which are to understand how soaring U.S. trade deficits have resulted in U.S. WTO dispute initiations, and why the Northeast Asian economies' response to U.S. dispute filings against them have differed. More specifically, the main objective of this chapter is to examine and scrutinize how the U.S. has imposed protectionist pressures on each of the three East Asian economies via the WTO, and to contrast each of their responses based on their domestic institutional mechanisms – which were readily available or established in response to the pressures – with regard to their WTO participation. The chapter will proceed as follows: first, it will lay out a brief description of the WTO DSB and the process of a dispute settlement in the WTO, then it will quantitatively investigate the role of U.S. trade deficits in U.S. dispute initiations in the WTO, then qualitatively investigate the varied responses from Japan, South Korea, and China with respect both to U.S. dispute initiation and their own methods of utilizing the WTO DSB system. The chapter will conclude with the ramifications as to whether the WTO will continue to be a venue for shaping trade policy for the countries addressed.

### **The WTO Dispute Settlement Body**

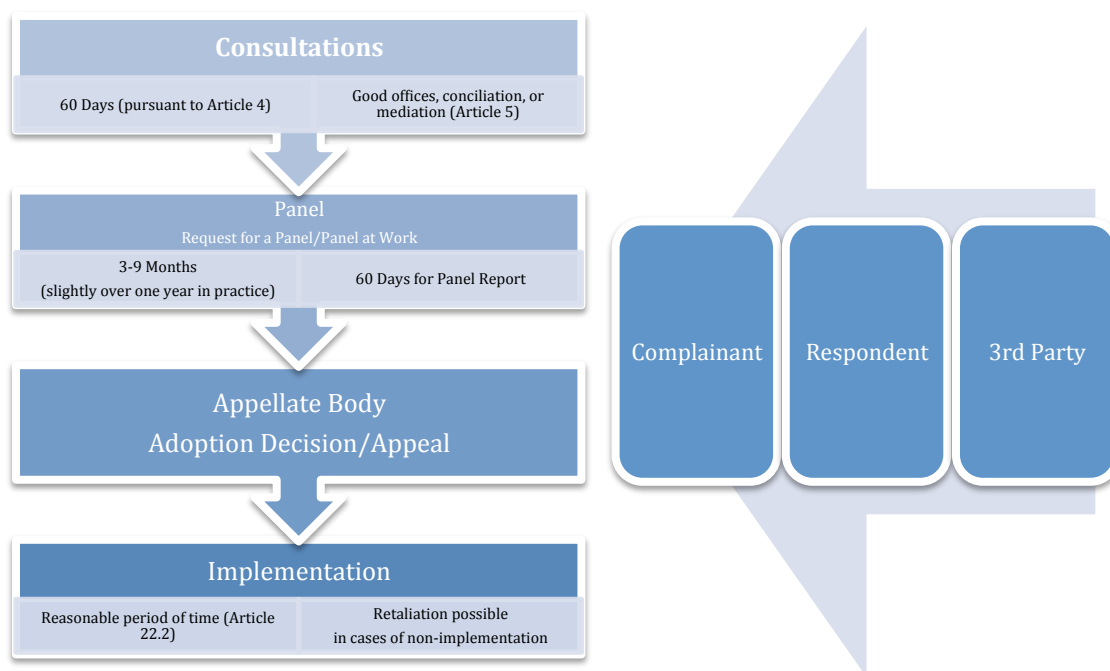
The WTO Dispute Settlement Body operates on a system based on the effective enforcement of negotiated rules. This is a precondition for the trading system to work, and the DSB system compels each WTO member to comply with a negotiated agreement so as to prevent being placed in a situation that is worse than in a compliance situation.<sup>169</sup>

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<sup>169</sup> Hoekman and Kostecki, 2009. p.85.

While the violation of WTO rules by a member may be certain and apparent, the rules and legal provisions that member states have agreed on are quite extensive and at times ambiguous. The discrepancy between the members' violation or non-violation actions and the rules that are readily available in writing is the basis of disagreement, and the need for a venue to dispute for varying interpretations. Despite the shortcomings of ambiguity in the dispute settlement system, it is by far the most agreeable platform for resolving trade disputes for the WTO membership totaling 160 member states (as of June 26, 2014) that retain different domestic laws and institutions.<sup>170</sup>

**Figure 4-1. The Main Stages of the WTO Dispute Settlement Body and Adjudication**



Source: By author

The DSB system offers a thorough and technical process of resolving a trade dispute. The stages for the dispute settlement starts with the bilateral consultations process, in

<sup>170</sup> The World Trade Organization ([http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm))

which members are obliged and encouraged to attempt to solve their disputes via bilateral negotiations. However, if the parties cannot reach an agreement via bilateral consultations, a panel would be set up and a very tedious process toward reaching a panel decision and report on the case disputed, and monitoring of compliance. As seen in **Figure 4-1**, member states of the WTO may bring a case to the DSB as a complainant, to which a respondent country will respond and defend its position. Other members that are not involved in the case may participate as third parties contingent on authorization by the panel and the parties directly involved.

During the first stage of bilateral consultations, the parties may reach an informal settlement at any time. However, if the parties are not able to settle their agreement within 60 days of consultations, they may request the establishment of a dispute settlement panel in the DSB. In this second stage of panel establishment, third parties may join as observing members contingent on approval of the DSB. About three or four panelists are suggested by the WTO Secretariat to sit on the panel, contingent on approval by the two parties involved in the dispute. While at work, the Panel examines the facts and the two parties' arguments, holds meetings with the parties involved and also with the third parties, issues interim reports and drafts recommendations on resolving the dispute. In the end, a panel report is issued to bring about implementation on the dispute. In the third stage, the panel report is either adopted by the DSB and the two parties reach a consensus, or a party disagrees with the panel report and appeals to the DSB. The Appellate Body, consisting of seven persons, judges the matter of law and legal consistency, and issues a report that is final and adopted by the DSB. Finally, in the

implementation stage, if immediate compliance is impractical, a reasonable amount of time is given to the offending party, and the period of time is decided based on arbitration. However, if the offending party fails to act within the given period of time, the parties negotiate compensation pending full implementation. Furthermore, if such negotiation is not feasible, the complainant to the dispute may retaliate – that is, it may request the DSB to authorize suspension of equivalent concessions against the offending party based on WTO rules.<sup>171</sup>

### **Literature on Dispute Initiation in the WTO**

The literature on WTO dispute initiation is very broad and includes the disciplines of economics, international relations, political economy, and international trade law. Over the past two decades since the establishment of the organization, scholars in various disciplines have examined a wide range of variables that could lead to a country to initiate a dispute in the WTO. Mainly observing the U.S. cases in the WTO, Grinols and Perrelli have argued that political variables are significant in the initiation of trade disputes and in their length of adjudication.<sup>172</sup> Using U.S. Section 301 trade dispute data, their analysis emphasized the role of the U.S. trade law in the form of the Omnibus Trade and Competitiveness Act of 1988, which has the effect of increasing the number of cases by creating a “conveyor belt” of case initiation. They also argued that when the caseload of the USTR exceeded 14, initiation became less likely due to government resources limit, even for a large government like the United States – implying that governmental

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<sup>171</sup> For a full description of the detailed legal procedures of the WTO dispute settlement, see Hoekman and Kostecki, *ibid.* pps. 89-90. Also for a full flowchart of the panel process, see under the section ‘Settling Disputes’ in ‘Understanding the WTO’, published and regularly updated by the World Trade Organization. ([http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/disp2\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp2_e.htm))

<sup>172</sup> Grinols and Perrelli, 2002.

factors can influence WTO dispute initiation. Shaffer (2003) has argued that a public-private partnership in the litigation process influences WTO dispute initiation. Because only member states are allowed to sue in the WTO, private firms, equipped with the financial means to fund legal assistance for the dispute initiations, are compelled to partner with public entities, and vice versa. Most recently, Davis (2012) has argued that states use international adjudication in the WTO in order to manage domestic political pressure and to pursue international cooperation.<sup>173</sup>

### **U.S. Trade Deficits and U.S. Dispute Initiation in the WTO**

U.S. trade deficits are the differences between the value of U.S. exports and U.S. imports. The fundamental cause of the deficits is excessive spending by U.S. consumers, businesses, and the government, but foreign trade barriers can influence the profitability of U.S. exporters, bilateral trade balances, and ultimately the aggregate trade balance.<sup>174</sup> The U.S. trade deficits have been accumulated over the past four decades since the early 1970s (see **Figure 4-2**), and is sustainable as long as foreign investors are willing to buy and hold U.S. assets – in most part government securities (U.S. Treasury bills) and financial assets. Reducing the trade deficit requires policy kits comprising direct measures of trade policy (i.e., imports and exports, exchange rates) and indirect measures

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<sup>173</sup> Davis, 2013.

<sup>174</sup> ‘Trade Primer: Qs and As on Trade Concepts, Performance, and Policy’ in Dena B. Torres eds., ‘U.S. Trade: Key Concepts, Policies and International Trends’, Series in Trade Issues, Policies and Laws, Novinka, 2013. pp.9-19.

of monetary and fiscal policy (i.e., interest rates, saving rates, budget deficits, capital flows).<sup>175</sup>

While the array of literature on dispute initiation in the WTO provide us with some interesting legal, institutional, and political insights on understanding the intent of states, businesses, and institutions, the WTO literature still leaves room for investigation into political and economic factors of the WTO dispute initiation dynamics. I contend that although the final decisions to launch an investigation may be more political than economic in a domestic spectrum, both political and economic factors of the trade dispute must be examined. Noting that changes in real exchange rate levels lead to pressures on politicians to provide relief from the resulting economic pressures on firms in tradable sectors, Copelovitch and Pevehouse (2010) have argued that countries facing exchange rate pressures will be more likely to placate domestic demands for protection by filing WTO dispute claims.<sup>176</sup> While their dependent variable suggests that exchange rate pressures is an important economic variable that may be a root cause for instigating WTO trade disputes, I suspect that there is an additional economic factor – import surges – which could be a more important cause. This is because without an actual import surge, it is very difficult to gain complaints from the industries and also political momentum toward actual dispute filing bureaucratically. In this section, I investigate the role of trade imbalances that the U.S. has had with its trading partners in WTO dispute initiation. As

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<sup>175</sup> Torres, *ibid.* p.13. While monetary and fiscal policy is the most effective method to reduce trade deficits, the primary target of the two policies is the conditions of the U.S. macroeconomy and trade deficit is a secondary target.

<sup>176</sup> Copelovitch and Pevehouse, 2010.

seen in **Figure 4-2**, the U.S. has been mounting trade deficits against the world overall, and in particular with its major trading partners of Europe and Asia.

**Figure 4-2. U.S. Trade Deficits against the World**



Source: U.S. International Transactions Accounts Data, Bureau of Economic Analysis

## Contributions to the WTO Dispute Initiation Literature and the Role of Trade

### Imbalances

The discussion on trade balances and trade policy has been most prevalent – and considered most relevant – in the policy realm rather than in academia, where economists have not been able to agree on the significance of the trade balances variable.

Nevertheless, as the trade deficits issue resurfaced in the face of China's economic expansion, it became a major issue in the U.S. domestic policy sphere. Since China entered the world economy via WTO accession in 2001 and started accumulating huge trade surpluses, China has become a main target of WTO dispute initiation by the United States. Contributing to the American public's unsettling views on trade deficits was widespread domestic media frenzy boosting the images of China as a culprit for U.S. unemployment. The question is then, have U.S. trade deficits driven policy actions? How

can we link descriptive analysis in the media or policy reports emphasizing the rise of trade deficits to actual policymaking? After all, it still remains a question whether the U.S. WTO dispute initiations on China or other countries actually stem from concerns regarding trade deficit accumulation.<sup>177</sup> This research gap is the basic starting point of this chapter, and where the ultimate goal of the chapter falls in.

Looking into the literature in various fields, one may be surprised to find how little attention has been given to the linkage between trade deficits and policy change.<sup>178</sup> First and foremost, in the field of macroeconomics, many economists have refrained from supporting the significance of bilateral trade deficits based on the fact that trade deficits may be offset by the accumulation of current account surpluses.<sup>179</sup> However, despite the ‘natural’ characteristics of trade imbalances in macroeconomic theory, other economists were able to identify and link the importance of trade deficits in terms of policymaking. In the coauthored report for the Federal Reserve Bank of Chicago, Bown, Crowley, McCulloch and Nakajima (2005) assert that although the occurrence of trade deficits may be a natural phenomenon, bilateral and sectoral imbalances in certain industries do become a focus of attention when they are large and trigger changes in policy. They

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<sup>177</sup> Han Liyu and Henry Gao refer to Reference News (January 26, 2008) to support the linkages between mounting U.S. bilateral trade deficits with China and actual U.S. dispute initiation in the WTO. In January of 2008, then USTR Susan Schwab noted that the U.S. trade deficit with China was ‘unsustainable’, suggesting further WTO complaints would follow. See Han Liyu and Henry Gao’s chapter in Schaffer and Meléndez-Ortiz ed., 2010. p.157.

<sup>178</sup> Hoeffner ed., 2010. Nonetheless, there have indeed been scholarly efforts to identify the sources of huge U.S. trade deficits by economists and policy analysts. For example, scholars have been keen on identifying the linkages between the price of oil and the impact of such price changes on economies around the globe, thereby identifying a causal relationship between the dollar and the price of oil and providing an assessment on the impact a range of prices of imported oil could have on the U.S. trade deficit.

<sup>179</sup> Cooper, 2005. In his policy brief for the Institute for International Economics, Cooper contended that U.S. current account deficit accumulation is sustainable and natural in today’s highly globalized economy. He attributed the continuance of trade deficits to America’s production of attractive financial assets.

explain these policy changes as giving rise to policies that focus on specific trading partners or traded products rather than on the macroeconomic conditions that underline the overall imbalance.<sup>180</sup> The main argument in this chapter adheres to Bown et al (2005)'s assertion that sectoral trade imbalances give rise to policy changes, but does not neglect the significance of overall trade imbalance on trade policy setting. In this chapter, I contend that both overall and sectoral imbalances contribute to a policy action, explaining the effect of overall trade imbalances in the quantitative analysis section and sectoral imbalances through case studies.

In the field of international political economy, the scholarly attention on trade imbalances has been quite minimal, and more prevalent in the field of trade or economic policy. One of the seminal works by Davis on WTO adjudication (Davis, 2012) uses trade balances, but not trade deficits, as a control variable in measuring the states' intent for dispute initiation. Before delving into her analysis further, it is important to point out that the focus of Davis's argument is not on the importance of trade imbalances, but rather on how regime type influences WTO dispute initiation behavior of states. In answering why states adjudicate, Davis argues that states use international adjudication in order to manage domestic political pressure and pursue international cooperation. In her analysis, she controls for the structure of trade relations – trade balance and share of exports. Although not central to her analysis, she uses the World Bank's World Development Indicators trade data to explain that countries that run surpluses tend to file more dispute initiations.

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<sup>180</sup> Bown et al, 'The U.S. Trade Deficit: Made in China?', *Economic Perspectives*, The Federal Bank of Chicago, 2005.

Methodologically, Davis's analysis presents an overall perspective of trade adjudication because it incorporates years in which data are available throughout both the GATT and WTO periods, and the subjects of her study are 81 countries in total. Her findings cover overall dispute initiation of states worldwide, not just the United States, in a long timeline. The statistical significance supporting her thesis that trade balance corresponds with greater adjudication activity is only salient in the models that are for the full periods from 1975-2004.<sup>181</sup> For the model run for the WTO cases from 1995-2004, the coefficient is minimal and statistically insignificant. Davis's analysis leaves room for additional and updated research on the impact of trade balance and WTO dispute initiation.

The analysis in this chapter is focused mainly on U.S. bilateral trade policymaking via WTO adjudication. My contribution to the trade imbalances literature is two-fold: to identify the intersections between trade deficit accumulation and policy action in the United States, and to update the literature on WTO dispute cases by extending the periods of investigation to 1995-2013 with the goals of identifying the linkages between trade deficits and dispute initiation. In other words, the ultimate contribution of this chapter to the literature on trade imbalances and dispute initiation is on how we should expect trade deficit to trigger WTO dispute initiation by the United States. My findings suggest an updated analysis of U.S. dispute initiations in the WTO, and how trade deficits have influenced U.S. dispute initiations. Through my case studies, I explain how the three East

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<sup>181</sup> Davis, 2012. p.82.

Asian economies have in turn responded to U.S. dispute initiations, and how they have in time each developed ways to file investigations against the United States.

### **Patterns of U.S. Dispute Initiation in the WTO**

It is very important to note that not all trade related issues are taken to the WTO for dispute initiation. Some cases are resolved at the level of domestic trade remedy, and pursuing a trade dispute case in the WTO involves potential for diplomatic or political conflict. Politics is heavily involved in the process toward a USTR decision, as seen in the highly selective way in which the U.S. has pursued cases in the WTO. That said, the U.S. is inevitably an aggressive player in the WTO. As a complainant, of the total of its 112 complaints (103 original, 9 compliance), 74 (including 2 that are partially concluded) have been concluded. 8 cases were merged with other complaints, 8 are in the litigation stage, and 24 cases are either in the pre-litigation bilateral consultation stage or currently inactive (including 2 cases that are partially concluded).<sup>182</sup> Meanwhile, as a respondent, of the total of 148 complaints issued against the U.S. (129 original, 19 compliance), 90 have been concluded, 27 were merged with other complaints, 10 are in the litigation stage, and 21 are either in the pre-litigation consultation stage or currently inactive.<sup>183</sup>

Note that the number of WTO cases initiated by the USTR slightly varies from what the WTO website offers, due to the point in time in which the number of cases was calculated, and taking into account the different stages of cases that evolve over time. For example, the USTR website dated May 22, 2014 states the number of U.S. cases as

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<sup>182</sup> The U.S. Trade Representative (USTR), 'Snapshot of WTO cases involving the United States', May 22, 2014.

<sup>183</sup> The USTR, *ibid.*

complainant as 112 cases and U.S. cases as a respondent as 148, whereas the WTO shows 107 cases and 121 cases (See **Table 4-1**). This discrepancy amongst USTR and WTO case counts can also derive from setting different criteria for cases actually filed, because unless a panel is set up in the WTO for a dispute settlement case beyond the consultation stage, the WTO website does not reflect the new case filed. In other words, the USTR data takes into account pre-litigation stages and count them as cases, whereas the WTO data does not and counts cases of which panels were set up for dispute settlement. Here, I use the WTO data series because it is more up-to-date and detailed with specific details.

**Table 4-1. WTO Dispute Settlement Cases (as of August 12, 2014)**

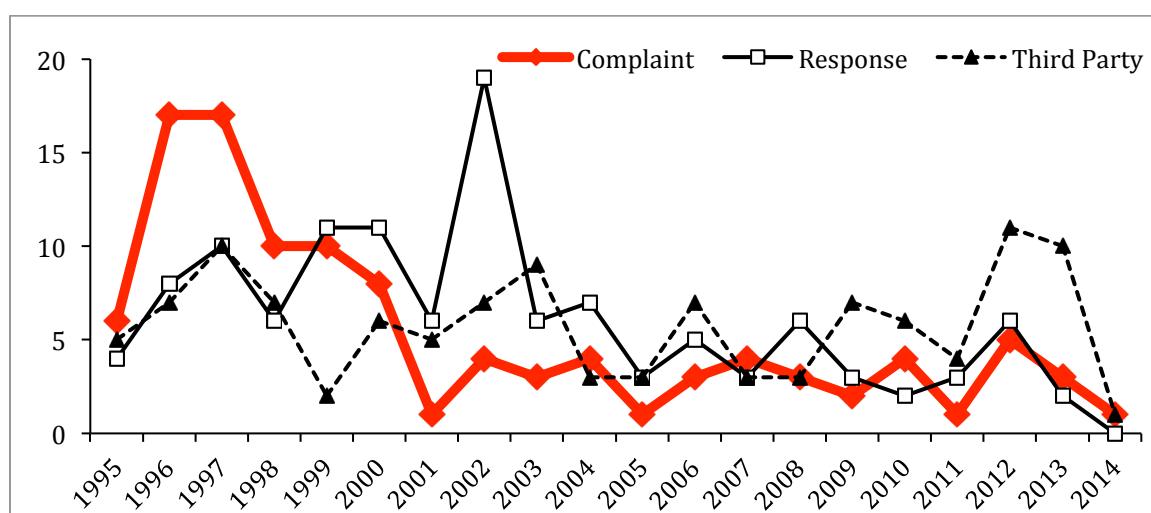
Country X	WTO Membership	As Complainant	As Respondent	As Third Party	U.S. against Country X amongst all Country X's responses (%)	Country X against the U.S. amongst all Country X complaints (%)	Country X as Third Party in U.S. cases (%)
United States	1 January 1995	107 cases	121 cases	116 cases	NA	NA	NA
Japan	1 January 1995	19 cases	15 cases	146 cases	6 of 15 <b>(40%)</b>	8 of 19 <b>(42%)</b>	95 of 146 <b>(65%)</b>
South Korea	1 January 1995	16 cases	14 cases	87 cases	6 of 14 <b>(42%)</b>	10 of 16 <b>(62%)</b>	55 of 87 <b>(63%)</b>
China	11 December 2001	12 cases	31 cases	112 cases	15 of 31 <b>(48%)</b>	9 of 12 <b>(75%)</b>	56 of 112 <b>(50%)</b>

Source: [www.wto.org](http://www.wto.org) ([http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_by\\_country\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm))

The patterns of U.S. participation in the WTO DSB have been changing over time, demonstrating different magnitudes at different time periods. In the beginning, the DSB was actively used as a test drive, and the U.S. filed in many cases in the same purpose of testing the DSB. The very first cases against Japan and South Korea were filed during this phase. The number of U.S. complaints dropped considerably in 2001 and 2005, but in other years it has maintained a modest number of complaints. As much as it trades with the rest of the world, the U.S. has been targeted continuously at the same time. In the year of 2002, cases against the U.S. skyrocketed, reaching a total of 19 cases. Japan, South

Korea, China, and even Chinese Taipei raised a case on U.S. safeguard measures on imports of certain steel products that year, and the U.S. was also targeted by its major trading partners such as Canada, the EC, and Brazil on cases ranging from lumber, fruits, and cotton. U.S. third party participation has peaked in recent years as well.

**Figure 4-3. U.S. Participation in the WTO (1995-2014)**



Source: [www.wto.org](http://www.wto.org)

### **Theoretical Discussion on Variables Leading to WTO Dispute Initiation**

Scholars in the field of IPE have explored the variables leading to dispute initiations in the WTO in various ways. There could be several variables impacting the policy decision for launching a dispute case in the WTO. Chad Bown, a leading scholar on WTO disputes and domestic trade remedy (AD/CVD), has looked at the linkages between trade remedy and WTO case filing, and has argued that not only the size of the economy and capacity to retaliate under WTO Dispute Settlement Understanding authorized sanctions but the original capacity to directly retaliate via AD/CVD measures impacts the

government's decision whether to file a WTO case.<sup>184</sup> Using a negative binomial regression model, Christina Davis (2012) has examined the role of different political regime types and economic status of states - democracies and authoritarian regimes, developed and developing economies - influencing WTO dispute initiations.<sup>185</sup> Using a zero-inflated count data model, Thomas Sattler and Thomas Bernauer have investigated the effects of economic power, trade dependence, and domestic politics toward WTO dispute initiation, and argued that bilateral trade volume is necessary for dispute initiation, but does not have a substantive effect on the number of initiations. Rather, they argue domestic politics is more important than economic power (in terms of bilateral trade volume) and trade dependence in explaining WTO dispute initiation.<sup>186</sup> Copelovitch and Pevehouse have investigated the effects of currency appreciation on WTO dispute initiations.<sup>187</sup> Using probit models, Busch, Reinhardt, and Shaffer have argued that legal capacity of a state is a substantive factor that leads to a WTO dispute initiation.<sup>188</sup>

When it comes solely to U.S. WTO dispute initiation patterns, there are still new venues to explore, including the impacts of bipartisanship or party politics on U.S. WTO dispute initiation (i.e., whether the U.S. initiates more cases under a certain political

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<sup>184</sup> Chad P. Bown, 'Trade Remedy and World Trade Organization Dispute Settlement: Why So Few Challenged?', World Bank Policy Research Working Paper 3540, March 2005.

<sup>185</sup> Davis, 2012.

<sup>186</sup> Thomas Sattler and Thomas Bernauer, 'Dispute Initiation in the World Trade Organization', draft research paper ([http://wp.peio.me/wp-content/uploads/2014/04/Conf1\\_Bernauer.Sattler\\_Dispute.Initiation.WTO\\_.pdf](http://wp.peio.me/wp-content/uploads/2014/04/Conf1_Bernauer.Sattler_Dispute.Initiation.WTO_.pdf)).

<sup>187</sup> Mark S. Copelovitch and Jon C. Pevehouse, "'Currency Wars' By Other Means? Exchange Rates and GATT/WTO Dispute Initiations', draft research paper ([https://ncgg.princeton.edu/IPES/2010/papers/F220\\_paper3.pdf](https://ncgg.princeton.edu/IPES/2010/papers/F220_paper3.pdf)).

<sup>188</sup> Marc L. Busch, Eric Reinhardt, and Gregory Shaffer, 'Does Legal Capacity Matter? Explaining Dispute Initiation and Antidumping Actions in the WTO', Issue Paper No. 4, ICTSD Dispute Settlement and Legal Aspects of International Trade, December 2008 ([http://www.ictsd.org/downloads/2009/02/legal\\_capacity.pdf](http://www.ictsd.org/downloads/2009/02/legal_capacity.pdf))

party's dominance in the Congress), or other factors such as the leadership change of the USTR on deciding which cases to pursue in the WTO, although typically the nature of the USTR has not depended entirely on the head of the organization. But the point of investigation in this chapter is that amongst all of the interesting variables to explore on WTO dispute initiation, there is a need for research focusing on the economic aspect of U.S. trade that influences its decision toward WTO dispute initiation, there is a research gap on the impact of U.S. bilateral trade imbalances on WTO dispute initiation.

### **Contribution to the Literature**

I propose an events count model analysis that focuses solely on U.S. bilateral trade imbalances and its impact on dispute initiation in the WTO. There is every need for research focusing mainly on U.S. bilateral trade imbalances that lead to U.S. dispute initiation in the WTO in order to figure out if there is a yearly, bilateral economic component that contributes to the dispute initiations by the U.S. By doing so, we would be able to find out whether the augmentation of U.S. bilateral trade imbalances with each of its trading partners actually results in the rise of WTO dispute initiations by the U.S. is true. But most of the studies that have been conducted are either focusing on all WTO members, due to the strong dependence on large- $n$  data in analyzing WTO disputes, most of the previous research has focused on WTO membership as a whole, or core members of the WTO. In previous studies, the U.S. is only a part of the whole when it comes to analyzing WTO dispute initiation patterns. Previous studies have also focused mainly on the role of political variables (i.e., regime type) that lead to dispute initiation, and there is

room for research that underlines the impact of economic factors rather than political ones.

### **Variables and Hypothesis**

#### *Dispute Initiation Measures - Dependent Variable*

The dependent variable to be measured is the number of WTO trade dispute initiation filed by the U.S. against a country X from 1995 to 2013. Currently, the WTO membership is 160 members, and a considerable portion of these countries (i.e., least developed countries) have never been involved in a WTO dispute with the U.S. The U.S. and the EU are the most active users of the WTO DSB system, and their counterparts are usually countries that trade with them extensively. Thus, it would be irrational to include all of the 160 countries in the dataset, because then it would be difficult to capture the relationship between trade deficits and actual dispute behavior. I set the following criteria for selection of country observation. Because the list of U.S. top trading partners varies over time, I rely on the WTO dispute settlement records to identify any countries with which the U.S. has been involved in a trade dispute in the WTO, either as a complainant, respondent, or a third party. The fact that the U.S. was involved in an actual dispute with a country X proves that there is sufficient trade activity or indirect trade interest from the U.S. side concerning that country X. Thus, I narrow down my observations to the main trading partners of the United States that have faced a WTO dispute with the U.S. at least once since joining the WTO.

The following 27 countries have been involved in a WTO dispute case filed by the U.S.: Republic of Korea, Japan, European Union, Australia, Canada, Hungary, Pakistan,

Portugal, Turkey, India, Brazil, Argentina, Indonesia, United Kingdom, Ireland, Philippines, Belgium, Denmark, Sweden, Mexico, Chile, Greece, Netherlands, France, Romania, Egypt, and China. Countries that have filed a WTO dispute case against the U.S. include the 27 countries and another list of 11 countries, which are: Venezuela, Costa Rica, Colombia, New Zealand, Switzerland, Norway, Chinese Taipei, Antigua and Barbuda, Thailand, Ecuador, and Vietnam. There are countries that have never been directly involved in a case against the U.S. but have been involved in cases in which the U.S. took part as a third party are the following 12 countries: Peru, Guatemala, Nicaragua, Uruguay, Dominican Republic, Panama, Honduras, El Salvador, Moldova, Ukraine, Cuba, and Russia. Because these countries were not directly involved in a trade dispute with the U.S. in the WTO DSB, they only represent zero cases of U.S. dispute initiation. For this reason, I have not included them in the dataset and have only included countries that were directly involved with the U.S. in cases that the U.S. served as a complainant or a respondent, a total of 38 countries.

*Trade Deficits/annual US GDP Measures - Independent Variable*

The independent variable to be measured in Hypothesis 1 is the yearly U.S. trade deficit with a specific bilateral trading partner X as a percentage of U.S. GDP of that year from 1995 to 2013. For the analysis in this chapter, the calculation for the trade deficits variable derives from subtracting imports of goods and services and income payments from exports of goods and services and income receipts, of which both figures are included in the current account. Simply put,

$$U.S. Trade Imbalances = (X - M)$$

The U.S. annual gross domestic product (GDP) data (unit: GDP in billions of current dollars), which is used to give weight to the trade deficit variable, is from the Bureau of Economic Analysis of the U.S. Department of State (dated July 30, 2014).<sup>189</sup> By dividing the trade deficit per year with the U.S. GDP per year, the independent variable specifies the proportion of the trade deficit as a percentage of U.S. GDP of a specific year.

### *Control Variables*

Toward the USTR's decision to launch a dispute initiation, there may be multiple factors to take into consideration. It is understood that while the U.S. receives numerous petitions for trade remedy as explained in Chapter 3, only a handful of cases can be addressed via the USTR due to the administrative capacity and political, diplomatic relationships that must be maintained with the trading partner. The following are some critical factors that must be controlled for in the regression analysis in order to make sure that the relationship between the independent variable (U.S. trade deficit/GDP per year) and dependent variable (number of dispute initiation per year). All of the control variables present possibilities of impacting the USTR's decision either directly or indirectly in filing a dispute initiation, or contributing to the political atmosphere that pushes the USTR to a position to file a dispute initiation.

#### 1) Log of Foreign Exchange Reserves of the Trading Partner X

The amount of foreign exchange reserves the trading partner accumulates may stir controversies in the U.S. Congress when related to trade deficit discussions, and media reports often address the issue of foreign exchange reserves accumulation of

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<sup>189</sup> Current-dollar and "real" GDP, National Economic Accounts, Bureau of Economic Analysis, U.S. Department of Commerce (<http://www.bea.gov/national/index.htm#gdp>)

the trading partner to magnify the trade imbalances aspect of the bilateral trade relationship. The justification for deploying the log of foreign exchange reserves of trading partner X as a control variable is to control for frictions that may arise due to the political pressures under speculations that currency manipulation is ongoing based solely on the size of a trading partner's foreign exchange reserve.

## 2) U.S. Unemployment Rate per year

As in the context of foreign exchange reserves accumulation, unemployment rate also catches the attention of the general public, and can also be used by the media and lobbyists to pressure politicians and policymakers to take an action on a certain bilateral trade deficit at issue.

### *Hypothesis*

*H<sub>1</sub>*: The accumulation of trade deficit with a trading partner per annual U.S. GDP increases the probability of the U.S. initiating a WTO trade dispute (filing a complaint) with the trading partner.

The hypothesis that I posit here for my argument is straightforward: the relationship that I am seeking to unravel between the two variables is that the U.S. trade deficit generated by another trading partner as a percent of U.S. GDP that particular year, can actually lead to U.S. trade dispute initiation in the WTO. This is based on the expectation that the goal of U.S. trade policy is in large part intended to improve the capacity of Americans to compete in the global economy, and in achieving that goal, improving trade

statistics is a vital task for U.S. trade policymakers.<sup>190</sup> There could also be alternative variables, such as trade surges in a particular sector, which could serve as an independent variable. However, collecting and tracking trade surge data for each particular industry could be tricky and also unreliable.

### The Model

The dependent variable is count data, and for count data, a negative binomial model is deemed appropriate. However, as seen in **Tables 4-2** and **4-3**, because the vast majority of observations of the dependent variable are 0s and 1s, it is useful to deploy a logit model, as it treats any 2s or 3s as 1s (the dependent variable is either 0, 1, 2, or 3). The dependent variable is essentially binary, with only less than 2 percent of the observations being greater than 1, I have opted for a logit model. Nonetheless, results of the negative binomial regression are provided to show that both models yield basically the same results. For future research purposes, a zero-inflated poisson model would be useful to further scrutinize the effect of the independent variable on the dependent variable.

**Table 4-2. Distribution of the Dependent Variable**

Variable	Observations	Mean	Standard Deviation	Minimum	Maximum
<i>Complaint</i>	950	.1136842	.4024714	0	3

**Table 4-3. Proportion of the Dependent Variable (Number of Obs = 950)**

Variable <i>Complaint</i>	Proportion	Standard Error	[95% Conf. Interval]	
0	.9105263	.0092653	.8923434	.9287092
1	.0715789	.0083682	.0551566	.0880013
2	.0115789	.0034727	.0047638	.0183941
3	.0063158	.0025716	.0012691	.0113625

<sup>190</sup> 'U.S. Trade and Investment Policy', Independent Task Force Report No.67, Council on Foreign Relations, 2011.

The intent of pursuing both models is in demonstrating that changes in trade imbalance levels provide political pressures and domestic demands on policy makers to resolve the trade imbalance by resorting to a trade dispute in an international institution. The country fixed effects on both models enable the statistical program Stata to drop any country of which there were no complaints by the U.S. filed against any trading partner in the WTO in a certain year. Moreover, the country fixed effects go beyond eliminating countries that U.S. didn't file disputes against – they control for any non-time varying country characteristics that are observed or unobserved. By placing country fixed effects in the model, each country in the observation samples would have a different baseline probability and level of dispute initiation. Thus, the model is empowered by fixed effects toward focusing on the forces that cause variation in dispute initiation patterns with each country over time in the given period. In addition, the year effects are included to help account for the temporal trend in overall U.S. WTO dispute initiations.

### **Model Specification**

Before the model is presented, it should be noted that the current model is rather under-specified, and future research should improve the model by including more variables. The main issue of concern for the current model is the existence of omitted variable bias (OVB), which occurs only when factors correlated with both the dependent variable and the independent variable are omitted from the model. For instance, while factors like the partisan balance of power in the U.S. Congress may be potentially important predictors of general propensity to initiate trade disputes, it is unlikely to be a source of OVB because it is not correlated with trade balances with different countries of

observation. I include the log of foreign exchange reserves of the trading partner X as a control variable, because it could be a factor that is correlated with both the trade balances and the propensity to initiate dispute initiation. I also include the unemployment rate, not because it could be a potential source of OVB, but because it is existent in the political discourse in the media that could sway public opinion. The country fixed effects play a significant role in the model, underspecified as is, but future update on the model will focus on identifying and including other variables that could potentially result in OVB.

$$\begin{aligned}
 Pr(y) = USWTO\ complaint_{it} = & \beta_0 + \beta_1 Trade\ Imbalances_{it}/USGDP_{it} \\
 & + \beta_2 ForeignExchangeReservesAccumulation_{it} \\
 & + \beta_3 USUnemploymentRate_t \\
 & + Country\ Fixed\ Effects \\
 & + Year\ Fixed\ Effects \\
 & + \varepsilon_{it}
 \end{aligned}$$

where

*USWTO complaint<sub>it</sub>* = the expected value of the likelihood of the U.S. (to be specific, the USTR) filing a request for the establishment of a WTO panel to express its economic interest (WTO dispute initiation)

and

*Trade Imbalances/USGDP<sub>it</sub>* = bilateral trade imbalances (Exports-Imports) of each U.S. trading partner who is a party to the WTO divided by U.S. GDP per year (current US dollars)

*ForeignExchangeReservesAccumulation<sub>it</sub>* = the amount of foreign exchange reserves accumulation by each U.S. trading partner who is a party to the WTO

*USUnemploymentRate<sub>t</sub>* = the unemployment year of the U.S. in that given year

## Data Sources

*Dispute Initiation Data (DV)*

For the data on WTO dispute settlement, I combine manually collected data with the World Bank WTO Dispute Settlement Data (2011). While there are other avenues to collect WTO dispute settlement data outside the WTO website portal, most of them are not up to date. The most comprehensive dataset on WTO Dispute Settlement is the World Bank WTO Dispute Settlement Data by Henrik Horn and Petros C. Mavroidis, which covers various aspects of the WTO dispute settlement system, only covers WTO disputes initiated through the official filing of a request for consultations at the WTO from 1 January 1995 to November 3, 2011.<sup>191</sup> In order to conduct an updated analysis to the year 2014, I have manually added counts of dispute initiations by referencing dispute records displayed on the WTO website.

#### *Trade Deficits Data (IV)*

The international transactions (balance of payments) accounts data collected by the United States Census Bureau include all transactions between U.S. and foreign entities.<sup>192</sup> The current account includes exports and imports of goods, services, income, and net unilateral current transfers. The capital account includes mainly capital transfers, such as U.S. government debt forgiveness. The financial account includes transactions in financial assets, such as U.S. purchases and sales of foreign securities, foreign purchases and sales of U.S. securities, U.S. direct investment abroad, foreign direct investment in the United States, U.S. bank lending to foreigners, and U.S. bank borrowing from foreigners. The U.S. Census Bureau's trade balances data covers the time periods ranging

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<sup>191</sup> WTO Dispute Settlement Database (<http://go.worldbank.org/X5EZPHXJY0>)

<sup>192</sup> Foreign Trade data, United States Census Bureau. (<https://www.census.gov/foreign-trade/balance/c5700.html>)

from 1985 to 2014 (year-to-date). However, in consideration of the duration of the WTO dispute settlement data available, the model will only deploy trade imbalances data from 1995 to 2013.

#### *Foreign Exchange Reserves Accumulation Data (CV)*

Comprised of data files from the International Monetary Fund, International Financial Statistics, the World Development Indicators dataset of the World Bank has a section on foreign reserves data (unit: total reserves including gold in current US\$). Total reserves comprise holdings of monetary gold, special drawing rights, reserves of IMF members held by the IMF, and holdings of foreign exchange under the control of monetary authorities. The gold component of these reserves is valued at year-end (December 31) London prices.<sup>193</sup>

#### *U.S. Unemployment Rate Data (CV)*

The data for yearly U.S. unemployment rate can be retrieved from the Bureau of Labor Statistics, of the U.S. Department of Labor.<sup>194</sup>

### **Results**

For both logit and negative binomial regressions, I have used both random and fixed-effects models in order to show comparisons between them – through the country fixed-effects, any country for which there were no complaints in the designated period is dropped, as seen in the number of observations decrease from 950 to 532 (Model 1 and Model 2). In Models 3 and 4, the log of foreign exchange reserves is missing 19

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<sup>193</sup> Foreign reserves data, the World Bank, World Development Indicators (<http://data.worldbank.org/indicator/FI.RES.TOTL.CD>)

<sup>194</sup> Bureau of Labor Statistics, U.S. Department of Labor (<http://data.bls.gov/timeseries/LNS14000000>)

observations, and the total number of observations is therefore 513. Year effects were added in order to check that there are no variations within years in terms of U.S. complaints, but both regression results did show that the earlier years from 1995 to 2000 (and 2001 for the negative binomial regression model) had higher propensities of U.S. complaints in the WTO.

**Table 4-4 . Estimated Coefficients of Logit Analysis for U.S. Dispute Initiation in the WTO (1995-2013)**

<i>Variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
Trade Balance/US GDP	-.1149438* (.0742858)	-.4015488*** (.0742858)	-.3517652*** (.1071647)	-.5008527*** (.1387809)
Log FX Reserves			-.5294112** (.2661305)	.175976 (.374373)
US Unemployment Rate			-.2349565** (.1168758)	.9259182 (1.67184)
Country Effects	Yes	Yes	Yes	Yes
Year Effects	No	Yes	No	Yes
Number of Observations	532	532	513	513

*Note: Models 2-5 are fixed-effects models. All models are for the period from 1995 to 2013. \* Significant at the 10 percent level. \*\* Significant at the 5 percent level. \*\*\* Significant at the 1 percent level. The regressions were run on Stata 11.2.*

Both regression results show that for the years 1995-2013, U.S. participation patterns in the WTO DSB with its trading partners have been influenced by U.S. trade balances with the trading partner, and the amount of foreign exchange reserves held by the trading partner, and U.S. unemployment rate also showed minimal impact in comparison to the log of foreign exchange reserves variable, but only in Model 3 in which year effects are absent. While an explanation is needed for the varying results with or without the year

effects, in both the logit and negative binomial regression models (**Tables 4-4 and 4-5**), the sign of the coefficient for the independent variable of interest is consistent with expectations and statistically significant across Models 1-4.

**Table 4-5. Estimated Coefficients of Negative Binomial Regression Models for U.S. Dispute Initiation in the WTO (1995-2013)**

<i>Variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
Trade Balance/US GDP	-.1014043** (.0522719)	-.4015488*** (.0978062)	-.3517652*** (.1071647)	-.5008527*** (.1387809)
Log FX Reserves			-.5294112** (.2661305)	.175976 (.374373)
US Unemployment Rate			-.2349565* (.1168758)	.9259182 (1.67184)
Country Effects	Yes	Yes	Yes	Yes
Year Effects	No	Yes	No	Yes
Number of Observations	532	532	513	513
Constant	.1030205 (.6887554)			

*Note: Model 1 is random-effects model, whereas Models 2-5 are fixed-effects models. All models are for the period from 1995 to 2013. \* Significant at the 10 percent level. \*\* Significant at the 5 percent level. \*\*\* Significant at the 1 percent level. The regressions were run on Stata 11.2.*

### **Case Studies: Institutional Variation in WTO DSB Participation**

Although member states may go through the same designated procedures in a WTO dispute settlement, the ways in which they go about it are different based on individual country practices. The case studies on the three countries reveal stark institutional variation.

## Japan

The most notable discourse on Japan's WTO DSB participation in recent years characterizes Japan's trade strategy as "aggressive legalism", defined by Pekkanen as "the active use of the legal rules in the treaties and agreements overseen by the WTO to stake out positions, to advance and rebut claims, and to embroil all concerned in an intricate legal game."<sup>195</sup> Despite some disagreements on this analysis by Japanese MOFA bureaucrats, some Western and Japanese scholars have agreed with the basis of her analysis while adding new evaluations of Japan's trade policy.<sup>196</sup> But while the argument on Japan's "aggressive legalism" stands and does explain a salient aspect of Japan's trade policy in recent years, it carries lesser weight if compared to South Korea's or China's participation in the WTO DSB. Amongst the three East Asian countries, Japan demonstrates the most reserved positions in WTO disputes (**Table 4-1**), but shows the most active participation as third party in the dispute settlement system. In relative comparison to its East Asian neighbors, Japan has positioned itself more as a bystander than a contender or a target since the launching of the WTO DSB in 1995. Japan acquiesces even in the WTO.

### *Japan's Trade Imbalances with the U.S. and WTO cases*

One explanation for Japan's reserved attitude that can be dated to Japan's participation in the GATT dispute settlement mechanism is that Japan's current account balance was a major factor in Japan's reluctance toward the active use of the GATT dispute settlement mechanism. Its permanent trade surplus put the government in an awkward position in

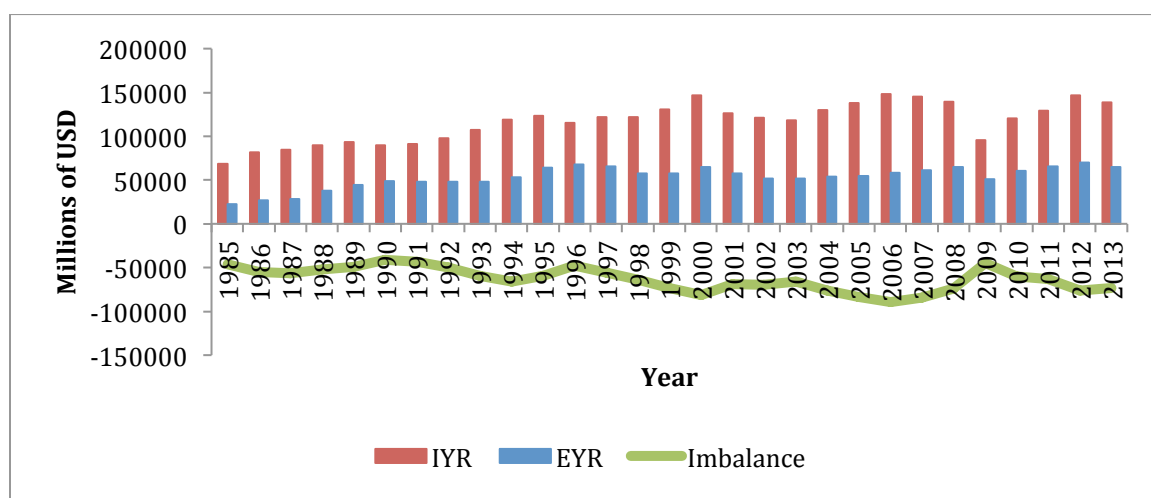
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<sup>195</sup> Pekkanen, 2001.

<sup>196</sup> Steger, 2010; Araki, 2004.

aggressively demanding foreign market access.<sup>197</sup> Japan's large trade surplus also made it vulnerable to foreign threats of market closure, and weakened its own threat to close off its markets (**Figure 4-4**).<sup>198</sup> While the argument on Japan's reluctance for litigation based on Japan's trade surplus may partially explain for Japan's insistence on having a reserved position in the international arena, the claim is not very new, and Japan's steady trade surplus has definitely played a role in shaping Japan's stance in the global economy. The limitations of the explanation based on Japan's trade surplus can be complemented with the institutional factors that shaped Japan's patterns of participation in the WTO.

**Figure 4-4. U.S.-Japan Trade Imbalances (1985-2013)**



Source: U.S. International Transactions Accounts Data, Bureau of Economic Analysis

Japan was most targeted by the United States in the initial years of the WTO DSB setup – 1995, 1996, and 1997. The cases in which Japan was targeted were on alcoholic beverages, photographic film, copyright sound recordings, and later on, agricultural goods. While Japan kept a steady surplus in trading with the U.S., Japan's trade surplus

<sup>197</sup> Yamane, 1998.

<sup>198</sup> Davis, 2012. p.191

with the U.S. had been on the rise since the year 1990 for five consecutive years toward the launch of the WTO. It fell slightly in 1996, but rose again in 1997.

*Japan's Institutionalism in WTO Dispute Participation*

From the GATT days, Japan has not been an active pursuer of disputes. It avoided the GATT dispute settlement process altogether and sought bilateral settlement instead if a panel were to be established in the GATT.<sup>199</sup> The trend for Japan's preference of bilateral consultations prior to a panel setup in the WTO dispute filing continues to this day. According to a set of surveys conducted on a number of developing or developed economies (who are WTO members) on the present practice of the delegations with regard to consultations in WTO dispute settlement, in the surveys, Japan and China have answered that consultations prior to litigation may be useful toward successful litigation, albeit depending on different situations.<sup>200</sup>

On the contrary, South Korea answered that bilateral consultations are not necessarily the catalyst for resolving trade disputes, but useful at information exchange, view exchange and the efficiency of the panel process.<sup>201</sup> Consultations do play a large part in clarification, mutual understanding of the trade conflict issue at stake, and also sending strong political signals.<sup>202</sup> Because they play such an important role, it is very reasonable that Japan relies heavily on resolving the issues at the consultation stage prior to an actual panel setup. Having settled issues prior to an actual launching of a dispute, Japan's actual case numbers could be far lower than those of its counterparts.

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<sup>199</sup> Pekkanen, 2008. p.17.

<sup>200</sup> Zhang, 2007. p.105.

<sup>201</sup> Zhang, *ibid.*

<sup>202</sup> Zhang, *ibid.*

Does Japan intend to play a low-key when it comes to disputes in the WTO due to its cultural reluctance for litigation? Do they prefer consultations to actual disputes because of their reluctance to contend? The answer is partially yes – as we will see in actual case studies, many of Japan’s WTO dispute initiations were resolved in amicable manners through a mutually agreed solution (MAS).<sup>203</sup> In the case of Japan, perhaps the lack of litigious culture and low legal capacity also could be a factor leading to reluctant and reserved characteristics in Japanese trade policy actions.<sup>204</sup> After all, cultures do influence the human behavior (even bureaucrats) and beliefs, and activity toward strategic planning and responses and thus cannot be overlooked. But cultural factors are not the central decisive factors that shape Japan’s behavior in the WTO.

Leaving all of the above listed factors and arguments aside – Japan’s consistent trade surplus, Japan’s preferences for consultations, or cultural reluctance to litigation – there are more deeply rooted domestic institutional factors that lead to Japan’s relative reluctance in comparison to its Chinese or Korean counterparts in the WTO. What this boils down to is the structure of Japan’s policymaking with regard to its participation in the WTO, or Japan’s institutional behavior toward WTO disputes. In order to investigate Japan’s institutional patterns on WTO participation further, we must look into how an actual WTO dispute participation by the Japanese government is decided, or framed within the ministries, in what strategic methods and policy coordination amongst the

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<sup>203</sup> Alschner, Wolfgang, “Amicable Settlements of WTO Disputes: Bilateral Solutions in a Multilateral System”, *World Trade Review*, 13:1, March 2014, pp.65-102.

<sup>204</sup> Davis, 2012. p.191.

ministries, and also how the industries and the government bureaus interact toward a dispute filing or response to a dispute.

In Japan, matters regarding WTO dispute initiation or WTO participation is in large part managed by the METI, MOFA, and to a lesser extent, the MAFF. The Multilateral Trade System Department of the Trade Policy Bureau of the METI plays the key role in defending its interests for export industries, while the MOFA plays the role of the intermediary between the METI and MAFF, and MAFF tries its best to reflect the interests of the relatively weak agricultural sector.<sup>205</sup> MAFF has the dual mandate to provide welfare for those in farming, fishing, and forestry, as well as to provide secure supply of food to the general population of Japan.<sup>206</sup> Because METI and MOFA generally favor agricultural liberalization, even MOFA at times has pressures for market opening and cannot accommodate the interests of MAFF.<sup>207</sup> While METI is mandated to fulfill the interests of its domestic industries, it is able to exercise its authority on case selections to pursue owing to Japan's fragmented political authority, and high delegation to the trade ministry in the Japanese political and bureaucratic system. In other words, METI officials that deal with trade disputes are able to make decisions on their own internally, without monitoring pressures by the Cabinet, or external individual requests from the individual

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<sup>205</sup> <http://www.mofa.go.jp/mofaj/gaiko/wto/funso/funsou.html>

<sup>206</sup> Davis, 2003. pp.125-126. It is true that MAFF gains political influence from Japan's main political party, the LDP, owing to the strong political ties that LDP politicians have with their countryside constituencies. However, given the importance and high proportion of Japan's export sectors in manufacturing and hi-tech industries as a percentage of GDP, and the frail circumstances of Japan's agricultural sector, METI's strategic planning for Japan's exports are given more weight in policy practice than MAFF's policy interests.

<sup>207</sup> Personal interviews with former high-ranking officials of the MOFA and MAFF reveal irreconcilable differences in approaching the issue of the Japanese agricultural sector and its competitiveness on the global market. MOFA sees that there is a need for the Japanese agricultural sector to be more competitive without significant reliance on safeguards and protection.

ministries. The high delegation without much political pressure involved makes a stark contrast between the functionalities of METI and those of the USTR, which is continuously pressured by the Congress and also the industries to fulfill their demands and requests via petitions and political lobbying.<sup>208</sup> Japanese Cabinet members may not be equipped with the ample knowledge on trade remedy, let alone the procedures toward a WTO dispute filing or response.

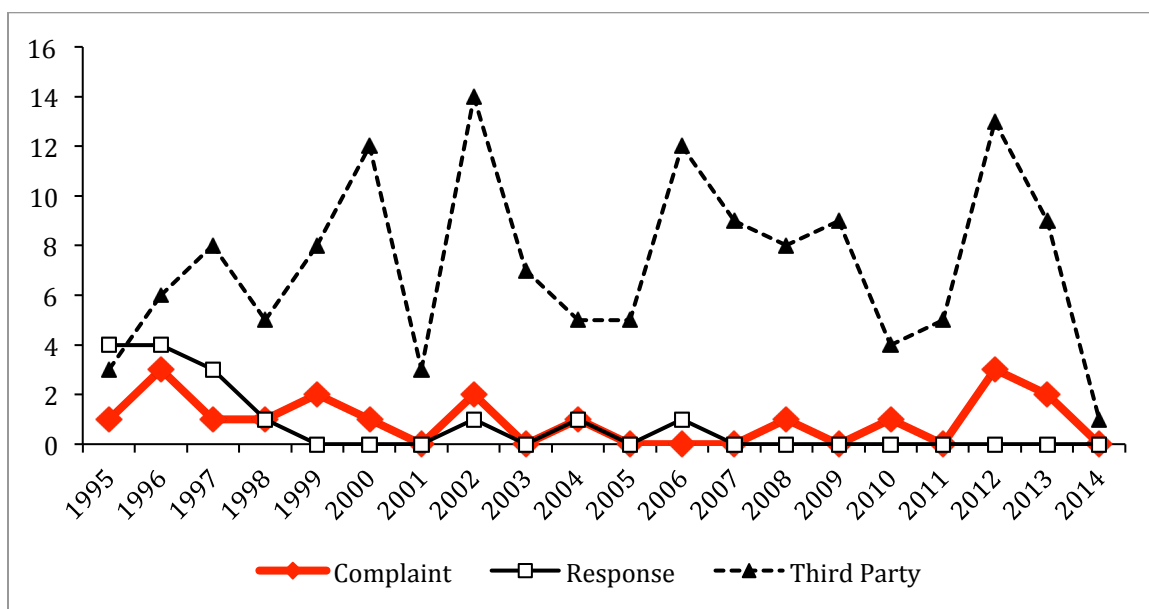
Japan's policy toward WTO disputes and its behavior throughout the WTO panel process is technocratic. In consultations prior to panel setup, there are other factors outside the dispute for judging whether to escalate or withdraw from the dispute. In Japan, neither media impact, nor NGOs, nor the civil society appear to have impact on the outcome of the consultations. Rather, Japanese officials believe that deliberation on a WTO case should be done solely on the basis of evidence and submissions.<sup>209</sup> This is a big divergence from the cases of China and South Korea, where the media have an impact on the cases. Among the three, only in South Korea has the impact of the civil society been an important factor (more elaborations in the following Korea section). Japan acquiesces in the WTO, but owing to its own structural reasons of policymaking. It acquiesces in relative terms when compared to its East Asian neighbors, but this does not mean that Japan is disinterested. Japan accumulates legal expertise rigorously via third party participations, but it is simply systematically disinclined to pursue trade disputes the way China does. Instead, it resolves trade issues bilaterally via consultations and negotiations.

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<sup>208</sup> Davis, 2012. p.193.

<sup>209</sup> Zhang, *ibid.* pp.113-115.

Figure 4-5. Japan's Participation in the WTO (1995-2014)



Source: www.wto.org

Table 4-6. U.S.-Japan Cases in the WTO DSB (1995-2013)

Case #	U.S. Complaint against Japan	Case #	U.S. Responses to Japan	Case #	U.S. as Third Party in cases involving Japan
DS11	Taxes on Alcoholic Beverages (July 1995)	DS6	Imposition of Import Duties on Automobiles from Japan under Sections 301 and 304 of the Trade Act of 1974 (May 1995)	DS55	Indonesia - Certain Measures Affecting the Automobile Industry (Complainant: Japan)
DS28	Measures concerning Sound Recordings (February 1996)	DS95	Measure Affecting Government Procurement (July 1997)	DS64	Indonesia - Certain Measures Affecting the Automobile Industry (Complainant: Japan)
DS44	Measures affecting consumer photographic film and paper (June 1996)	DS162	Anti-Dumping Act of 1916 (February 1999)	DS139	Canada - Certain Measures Affecting the Automotive Industry (Complainant: Japan)
DS45	Measures affecting distribution services (June 1996)	DS184	Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (November 1999)	DS323	Japan - Import Quotas on Dried Laver and Seasoned Laver (Complainant: Korea, Republic of)
DS76	Measures affecting agricultural products (April 1997)	DS217	Continued Dumping and Subsidy Offset Act of 2000 (December 2000)	DS336	Japan - Countervailing Duties on Dynamic Random Access Memories from Korea (Complainant: Korea, Republic of)
DS245	Measures affecting the importation of apples (March 2002)	DS244	Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan (January 2002)	DS376	European Communities - Tariff Treatment of Certain Information Technology Products (Complainant: Japan)
		DS249	Definitive Safeguard Measures on Imports of Certain Steel Products (March 2002)	DS412	Canada - Certain Measures Affecting the Renewable Energy Generation Sector (Complainant: Japan)

DS322	Measures Relating to Zeroing and Sunset Reviews (November 2004)	DS433	China - Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum (Complainant: Japan)
		DS445	Argentina - Measures Affecting the Importation of Goods (Complainant: Japan)
		DS454	China - Measures Imposing Anti-Dumping Duties on High-Performance Stainless Steel Seamless Tubes from Japan (Complainant: Japan)
		DS468	Ukraine - Definitive Safeguard Measures on Certain Passenger Cars (Complainant: Japan)

*Source: WTO*

### *Japan's WTO Cases with the United States*

Looking at the past decades of Japan's participation in the GATT and the WTO, Japan's litigant actions in the WTO show that Japan has indeed evolved into a more active litigant than it had been in the GATT years. Japan's gradual transformation into a litigant, albeit a reluctant one, is indeed in correspondence with Japan's 'aggressive legalism' literature. However, in the purposes of the analysis in the chapter, it matters most whether Japan is an active pursuer of WTO litigation in comparison with its East Asian competitors, South Korea and China. As much as the Japanese delegation favored resolving dispute matters via consultations, some of Japan's bilateral cases in the WTO DSB with the U.S. were resolved via mutually agreed solutions via bilateral consultations. These cases include the U.S. complaint on Japanese measures concerning sound recordings (DS28) and the Japanese complaint on the imposition of import duties on automobiles from Japan under Sections 301 and 304 of the Trade Act of 1974 (DS56). Even after a pre-consultation stage, Japan pursued the method of mutual agreement during the formal consultation stage prior to actual panel setup. Note again that the METI

does not favor unnecessary conflicts in the WTO DSB if it can resolve the disputes bilaterally via negotiation. The method of acquiescence is Japan's number one preference.

Then what type of cases did Japan decide to pursue? Given that the METI has almost complete authority with high delegation from the central government over which cases it will pursue in the WTO, the question on which Japanese cases in the WTO to look into becomes quite obvious. The answer is in steel. As much as steel production is a fundamental pillar that leads to all sectoral developments in the economy, the Japanese steel industry had been consistently the single most favored industry by the Japanese government. Under no circumstances would the METI leave the Japanese steel industry under market forces.<sup>210</sup>

METI's strong support for the Japanese steel industry is manifested in Japan's two important dispute initiations against the U.S.<sup>211</sup> In the Japanese complaint on U.S. anti-dumping measures on certain hot-rolled steel products from Japan (DS184), Japan sued the U.S. in the WTO DSB regarding the USITC and the USDOC's investigations on Japan's hot rolled steel products, which led to U.S. imposition of antidumping duties that Japan thought was erroneous. Just after the Asian Financial Crisis, major U.S. steel companies and the United Steelworkers of America launched a major campaign to ask the Clinton Administration to protect the U.S. steel industry from illegal dumping by Brazil, Russia, and Japan.<sup>212</sup> In simple terms, the need to protect the U.S. domestic steel industry prompted legal actions by the USTR via political support by the Congress and

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<sup>210</sup> Pekkanen, 2006. p.63.

<sup>211</sup> Another important case is Japan's complaint against U.S. definitive safeguard measures on imports of certain steel products (DS248), but this case was pursued not only by Japan but by several other member states as a group (i.e., Brazil, EC, China, New Zealand, Norway, Switzerland, and South Korea).

<sup>212</sup> Pekkanen, *ibid*, pp.65-67.

the Administration reliant on steel industry workers. Albeit in mixed legal outcomes due to strong U.S. appeals to the DSB in the aftermath of the Panel rulings, Japan in the end succeeded in compelling the U.S. to make small administrative changes in the method of its antidumping margins calculations.<sup>213</sup> Similarly, in Japan's complaint against the U.S. sunset review of anti-dumping duties on corrosion-resistant carbon steel flat products from Japan (DS244), Japan claimed that the USITC and the USDOC's determinations in the full sunset review were erroneous.<sup>214</sup> When the panel rejected Japan's argument that the USDOC's determination was not WTO-inconsistent and thus made no recommendations, Japan appealed and had four of the Panel's initial findings reversed. Nonetheless, the Appellate Body of the DSB did not make any finding that the US acted inconsistently with its obligations of the anti-dumping agreement or the WTO agreement.<sup>215</sup>

One exceptional case in which the Japanese mainly prevailed in a U.S. complaint on Japan was the U.S. complaint on Japan's measures affecting consumer photographic film and paper (DS44).<sup>216</sup> In May of 1995, the Eastman Kodak Company filed a petition with the USTR alleging that Japanese market practices prevent foreign film from access to the Japanese domestic market.<sup>217</sup> Again, industrial concerns from the U.S. domestic economy

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<sup>213</sup> Pekkanen, *ibid.* p.106. Also see WTO Dispute Settlement Case DS184. [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds184\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds184_e.htm)

<sup>214</sup> Kim, 2007. In August 1993, the USDOC levied 36.41% of antidumping duties on Japanese corrosion-resistant carbon steel flat products. In September 1999, the USDOC decided to continue antidumping measures to prevent domestic injuries or recurrence of injuries based on its sunset reviews, a process in which within a 5-year-term since levying AD duties, the USDOC makes a decision on whether to continue or discontinue the levy of AD duties.

<sup>215</sup> WTO Dispute Settlement Case DS244. [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds244\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds244_e.htm)

<sup>216</sup> WTO Dispute Settlement Case DS44. [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds44\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds44_e.htm)

<sup>217</sup> See 'The Kodak-Fuji Film Case at the WTO and the Openness of Japan's Film Market', by Dick K. Nanto, Specialist in Industry and Trade, Economics Division, CRS Report for Congress, May 8, 1998.

would find political means to bring a case to the WTO. At first, the U.S. sought to deploy Section 301 of the Trade Act of 1988 to impose punitive measures on a foreign government that overlooks private industries' practices against domestic antitrust laws. Japan defended the interests of its photographic film industry by contending that it has not violated its antitrust laws and narrowly escaped the Section 301 measures, thereby compelling the USTR to file the case in the WTO. Because the WTO has no agreement on competition policy, it was very difficult for the U.S. to win the case in the WTO by making a case out of competition issues. Additionally, on the same day of case filing for DS44, the U.S. alleged through its complaint on Japan's measures affecting distribution services (DS45) that Japan's measures affecting distribution services (not limited to photographic film and paper sector) through the operation of large-scale retail store law which regulates floor space, business hours and holidays of supermarkets and department stores nullify or impair benefits accruing to the U.S. and thus argued that Japan has violated GATS Article III (transparency) and Article XVI (market access).<sup>218</sup>

Overall, Japan's bilateral cases with the U.S. in the WTO involved U.S. domestic industries claiming for either more foreign market access or protection of its interests, actions that were primarily based on the fear of losing industrial profit. In other words, sectoral trade shifts prompted the U.S. industries or U.S. authorities to make the move, and in response, Japan has resisted the pressures via seeking its legal rights in the WTO DSB, albeit leading to small successes on the Japanese side. While it is not an exception when it comes to defending its proactive sectors aggressively, Japan, due to its

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<sup>218</sup> WT/DS45/1/Add.1; also see WTO Dispute Settlement Case DS45.  
[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds45\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds45_e.htm)

institutional reasons and strategic purposes, seeks bilateral consultations than a dispute initiation, and has often ended the dispute under mutually agreed solutions before the dispute expanded in full scale. Japan is also more active as a third party than South Korea or China.

### **South Korea**

#### *South Korea's Trade Imbalances with the U.S. and WTO cases*

Albeit smaller in absolute figures than Japan, South Korea has steadily generated trade surpluses in trading with the U.S., excluding the years 1995-1997 (see **Figure 4-6**). The South Korean trade deficits during these years were attributed to the unified tariff rates at 8% and the won-dollar rate (for details, see **Chapter 2**). In recent years, during the previous Lee Myung-bak Administration and the current Administration under President Park Geun-hye, the South Korean trade surplus from trading with the U.S. has been on the rise. This trend could be attributed to the effects of the KORUS FTA, which went into effect on March 15, 2012. However, as tariffs will be eliminated within a 10-year span, it remains a question whether South Korea ultimately will benefit in terms of bilateral trade surplus – whether it gains or loses from the trade deal remains to be seen for the time being. In addition, the effects of the FTA reflected into bilateral trade balances with the U.S. could be reversed if South Korea joins the Trans-Pacific Partnership (TPP) after the negotiations are concluded, and also if South Korea participates in the TPP.

Overall, the USTR's efforts in striking a trade deal with South Korea were mainly centered on getting further market access and paving the way for U.S. autos and agricultural goods (mostly beef – South Korea's culinary culture depends a lot on beef,

including parts that are normally not consumed by U.S. consumers) in the South Korean market. Meanwhile, South Korea always seeks to expand opportunities for its export industries in electronics and autos. Due to the unchanging characteristics of the competing markets of the two countries, the sectors of concern repeatedly give impetus to bilateral trade disputes or WTO dispute initiations.

*South Korea's Institutionalism in WTO Dispute Participation*

South Korea's stance toward WTO disputes is more reciprocal and less rigid than Japan's, but not as active or proactive as China's. As much as South Korea retains a very close trade relationship with the U.S., 62% of South Korea's dispute initiations in the WTO DSB have been targeting the United States (**Table 4-1**), whereas 42% of Japan's dispute initiations and 75% of China's dispute initiations have been targeting the United States. The statistics show that South Korea has grown quite reciprocal to U.S. pressures via WTO dispute initiations. South Korea is no longer a passive onlooker when it comes to trade disputes at the multilateral level, and bilateral consultations prior to actual panel setup remain as only an option and not the first and foremost preferred method. For instance, other than the U.S. complaint on South Korea's measures concerning the shelf-life of products (DS5), South Korea has rarely resolved WTO dispute via mutually agreed solutions (MAS). For South Korea, reciprocation is the method that it abides by in trade disputes with the U.S., but it is careful not to overstretch itself to retaliate like China does, due to the political ramifications it may bring to the U.S.-Korea relations, and it does not confine itself in acquiescence like Japan does, if it sees potential of winning a

case. It has also been very active in pursuing WTO dispute participation as a third party, which is a common trait among all three countries.

Before the Park Geun-hye Administration's cabinet and administrative reform that occurred prior to her inauguration, the trade bureau stayed in the MOFAT (currently the MOFA), but after the reform, the trade bureau was relocated to the MOTIE.<sup>219</sup> Hence, matters relating to WTO disputes from January 2013 have been entirely handed over to the MOTIE.<sup>220</sup> Previously, MOFAT retained a legal experts pool (외교통상부 통상법무과) that would serve as advisers to MOFAT's WTO dispute case initiations or responses. Since the trade bureau has been moved to MOTIE, the legal experts pool now works in close relations with the MOTIE (산업통상자원부 통상법무과). A large number of these lawyers are active both in U.S. and South Korean legal spheres to be updated on recent info and to exchange information, or are headquartered in the U.S. In other words, South Korea's delegation to WTO disputes can be described as flexible institutionalism via public-private partnership. While the MOTIE is involved in the actual processing of the cases, the Ministry of Justice (MOJ) also provides legal expertise on WTO dispute settlement and analyses of previous cases encompassing several sectors.

Other than the ministerial personnel for the WTO dispute delegation in MOFAT and MOJ, South Korea fully utilizes and incorporates the legal personnel capacity in the private law firms such as Yoon & Yang, LLC (법무법인 화우); Lee & Ko, LLC (법무법인 광장), which specializes in trade remedy, WTO disputes, BIT or FTA

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<sup>219</sup> [http://www.mofa.go.kr/trade/wto/dispute/index.jsp?menu=m\\_30\\_100\\_30](http://www.mofa.go.kr/trade/wto/dispute/index.jsp?menu=m_30_100_30)

<sup>220</sup> <http://www.motie.go.kr/motie/py/ce/wto/wto.jsp>

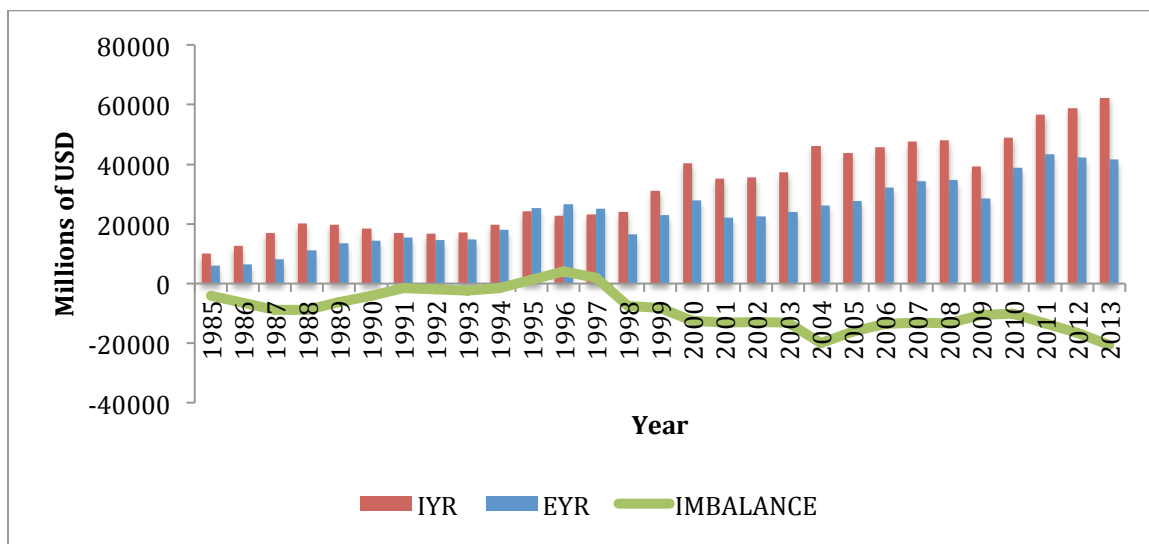
negotiations; Bae, Kim, & Lee, LLC (법무법인 유한 태평양), which handles all areas of legal disputes; Kim & Chang, LLC (법무법인 김앤장), which specializes in international commercial practice; and Shin & Kim, LLC (법무법인 세종), that have bureaus of legal experts specializing in trade disputes at bilateral or multilateral levels.<sup>221</sup> Over time, South Korea's pool of legal personnel has expanded and its mobilization of its legal personnel has grown more dynamic. South Korea's bilateral trade bureau (the MOTIE as of 2013) is involved in informal consultations, and at the formal consultation stage, the international trade law team, the Geneva-based delegation and international lawyers are included. The personnel therefore are different in informal and formal consultation stages.<sup>222</sup> Japan and China pursue a different method for organizing its personnel from South Korea's, and the Japanese and Chinese personnel remain the same for both informal and formal consultations. The implication in the South Korean case is that it takes the formal procedures rather than informal consultation stages more seriously as a venue of actual dispute. Also, Japan and China's consistency in its legal team members make their preparations toward cases smoother, as there is no asymmetry of information occurring in the process of the change of guards.

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<sup>221</sup> South Korea has a large pool of legal personnel through legal education at the undergraduate and graduate levels, Korean graduates with legal degrees from abroad, and also domestic personnel via the South Korean bar examinations. It has retained the bar examination system as the Japanese have, but since 2009 has also introduced the law school system just as the Japanese have. Personnel in private law firms include legal practitioners who have had extensive careers as judges or prosecutors, but also foreign educated law degree holders and recent law school graduates.

<sup>222</sup> Zhang, *ibid.*

**Figure 4-6. U.S.-South Korea Trade Imbalances (1985-2013)**

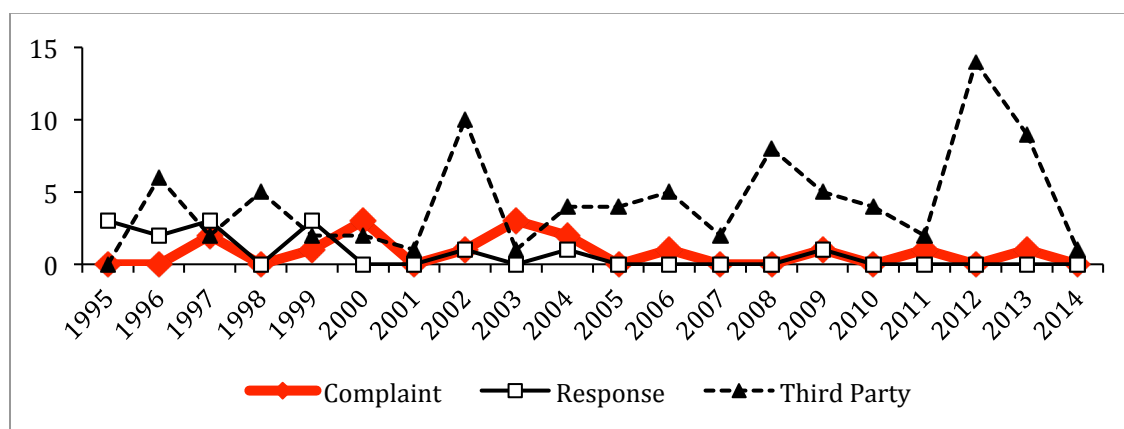


Source: U.S. International Transactions Accounts Data, Bureau of Economic Analysis

Sectoral trade imbalances for South Korean industries play an important role in taking actions, even by quarterly figures. Due to the industrial structure, which is quite similar to that of Japan, South Korean industries often times find themselves in the same shoes as Japan when involved in a trade dispute with the U.S. – conflicts arise mainly in the agricultural sector, the steel industry, or high-tech industry such as semi-conductors (DRAMs). To be fair, South Korea’s economic structure is best characterized as one with a strong governmental policy emphasis on manufacturing and technology and a frail agricultural sector. These are traits similar to the Japanese economy. However, industrial motivations and methods to defend their interests are more rigorous and eager than those of Japan’s. As in the cases of South Korean trade remedy structure, the relevant South Korean ministries are more eager and motivated to support its industries at the individual levels. South Korea also pays attention to the public eye and responses to trade disputes than the Japanese trade ministry does, because while the MOTIE is delegated to serve for

trade disputes, the strong Presidency which provides directions for the ministries is constantly conscious of public responses and the Presidency structurally has the upper hand in dictating policy choice. This is because South Korean party politics in general and for the most part, presidential election outcomes, can be heavily swayed by public responses. Therefore, the biggest difference between the delegation of trade issues to ministries in Japan and South Korea may be the monitoring mechanisms by the central cabinet. While Japan's METI has autonomous authority over its case selections, South Korea's MOTIE is more careful in selecting cases and its decisions get reported to the VIP level (the Presidency) if they involve sensitive issues regarding agriculture or a specific industry at stake, because once made public they will have political ramifications for the incumbent party.

Figure 4-7. South Korea's Participation in the WTO (1995-2014)



Source: [www.wto.org](http://www.wto.org)

Table 4-7. U.S.-South Korea Cases in the WTO DSB (1995-2013)

Case #	U.S. Complaint against South Korea	Case #	U.S. Responses to South Korea	Case #	U.S. as Third Party in cases involving South Korea
DS3	Measures Concerning the Testing and Inspection of Agricultural Products (April 1995)	DS89	Anti-Dumping Duties on Imports of Colour Television Receivers from Korea (July 1997)	DS98	Korea, Republic of - Definitive Safeguard Measure on Imports of Certain Dairy Products (Complainant:

DS5	Measures Concerning the Shelf-Life of Products (May 1995)	DS99	Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea (August 1997)	DS169	European Communities) Korea, Republic of - Measures Affecting Imports of Fresh, Chilled and Frozen Beef (Complainant: Australia)
DS41	Measures concerning Inspection of Agricultural Products (May 1996)	DS179	Anti-Dumping measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea (July 1999)	DS273	Korea, Republic of - Measures Affecting Trade in Commercial Vessels (Complainant: European Communities)
DS84	Taxes on Alcoholic Beverages (May 1997)	DS202	Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (June 2000)	DS299	European Communities - Countervailing Measures on Dynamic Random Access Memory Chips from Korea (Complainant: Korea, Republic of)
DS161	Measures Affecting Imports of Fresh, Chilled and Frozen Beef (February 1999)	DS217	Continued Dumping and Subsidy Offset Act of 2000 (December 2000)	DS301	European Communities - Measures Affecting Trade in Commercial Vessels (Complainant: Korea, Republic of)
DS163	Measures Affecting Government Procurement (February 1999)	DS251	Definitive Safeguard Measures on Imports of Certain Steel Product (March 2000)	DS312	Korea, Republic of - Anti-Dumping Duties on Imports of Certain Paper from Indonesia (Complainant: Indonesia)
		DS296	Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea (June 2003)	DS323	Japan - Import Quotas on Dried Laver and Seasoned Laver (Complainant: Korea, Republic of)
		DS402	Use of Zeroing in Anti-Dumping Measures Involving Products from Korea (November 2009)	DS336	Japan - Countervailing Duties on Dynamic Random Access Memories from Korea (Complainant: Korea, Republic of)
		DS420	Anti-dumping measures on corrosion-resistant carbon steel flat products from Korea (January 2011)	DS391	Korea, Republic of - Measures Affecting the Importation of Bovine Meat and Meat Products from Canada (Complainant: Canada)
		DS464	Anti-dumping and Countervailing Measures on large residential washers from Korea (August 2013)		

Source: WTO

### *South Korea's WTO Cases with the United States*

Conflict over trade in agricultural goods has been a chronic issue in U.S.-Korea trade relations. The U.S. complaints on South Korea's measures concerning the testing and inspection of agricultural products (DS3) in 1995 and measures concerning inspection of

agricultural products (DS41) in 1996 were the initial cases that the U.S. pursued right after the WTO DSB launch. The South Korean national sentiment on staple foods like rice and beef made U.S. market access into the South Korean agricultural market difficult (and there was safeguard on South Korean rice for a considerable time), and much of the trade negotiations between the two countries on beef had been rocky over the past two decades.<sup>223</sup> In February 1999, the U.S. filed a complaint in the WTO regarding South Korea's measures affecting imports of fresh, chilled and frozen beef (DS161).<sup>224</sup> The U.S. alleged that South Korea imposes a mark-up on sales of imported beef, that it limits import authority to certain so-called "super-groups" and the "Livestock Producers Marketing Organization" (LPMO), and that South Korea provides domestic support to the cattle industry beyond South Korea's aggregate measure of support reflected in its schedule. The U.S. contended that due to these restrictions, South Korea is denying national treatment to beef imports and that governmental support to the domestic cattle industry violate the Agreement on Agriculture. Interested members such as Australia, Canada, and New Zealand joined as third parties and observed the case as the Panel initially upheld U.S. assertions. In September 2000, South Korea appealed to the WTO DSB Appellate Body, and had several of the Panel's findings on recalculated amounts of Korea's domestic support for beef in 1997 and 1998 reversed. However, South Korea reported to the DSB that it would implement DSB's recommendations within a reasonable time period by September 18, 2001, which was a date mutually agreed upon

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<sup>223</sup> For instance, during the second round of KORUS FTA negotiations in 2008, media reports that U.S. beef contain potential viruses for the mad cow disease went viral amongst the South Korean public.

<sup>224</sup> WT/DS161, [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds161\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds161_e.htm)

with the U.S. However, U.S. alluded to further pressures into the future by concluding the case by expressing its intent to work with Korea to ensure that South Korean measures will result in full market access for U.S. beef. The debates on beef would continue as the KOR-US FTA negotiations were launched in 2006.

South Korea's actions in the WTO disputes culminated in its two complaints against the U.S. on its antidumping duty and countervailing duty on Dynamic Random Access Memory Semiconductors (DRAMs), which were filed by South Korea each in 1997 and 2003, respectively. After its invention, the semiconductor industry was initially spearheaded by U.S. industries in the 1950s and 1960s. Crisis came when Japan's rise in semiconductor production threatened U.S. industries in the 1980s (i.e., NEC, Hitachi, and Toshiba) and 1990s (i.e., Fujitsu and Mitsubishi in addition to the previous three), and South Korea's Samsung and Hyundai Electronics (later SK Hynix) also became a major producer from the late 1980s, 1990s and into the 2000s.<sup>225</sup> The chip industry has been pivotal to the development of South Korea's electronic industries, and still remains a central contributor to South Korean exports. Petitions started to flood into the USITC and USDOC from 1985 from U.S. companies such as Micron Technology.<sup>226</sup>

The threats on the U.S. semiconductor industry pleaded the USITC and USDOC to continue to levy duties on DRAMs from South Korea. In the South Korean complaint against U.S. antidumping duty on DRAMs of 1MB or more from Korea (DS99) in 1997, South Korea contended that the USDOC's decision not to revoke the antidumping duty on its DRAMs was made despite the finding that South Korean DRAMs had not been

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<sup>225</sup> Brown and Linden, 2009. p.18

<sup>226</sup> Malison, 1993. p.16

dumped on the U.S. market for more than three and a half consecutive years, and despite the evidence demonstrating that Korean DRAM producers would not engage in dumping in the future.<sup>227</sup> While the U.S. responded to the DSB by saying that it was seeking ways in which it will implement DSB recommendations in 1999, the USDOC in 2000 issued a revised final results of redetermination concluding that the antidumping order stay in place because a resumption of dumping was likely. Shortly after, South Korea asked the DSB Panel to suspend its work until further notice and instead, came to a mutually satisfactory agreement with the U.S., revoking the antidumping order at issue as the result of a five-year sunset review by the USDOC.

In a subsequent complaint on U.S. countervailing duty investigation on DRAMs from Korea, South Korea contended that the USITC's affirmative final injury determination and the USDOC's final countervailing duty order of 11 August 2003 were inconsistent with the Agreement on Subsidies and Countervailing Measures (SCM) of the WTO.<sup>228</sup> In the initial Panel report, the USDOC's findings of the South Korean government's financial contribution to Hynix, Inc. was found insufficient evidence by the DSB Panel, and the USITC's injury determination was found to be in violation of the USITC's obligation under Article 15.5 of the SCM agreement, for non-attribution.<sup>229</sup> The U.S. appealed to certain issues of law and legal interpretations developed in the initial Panel report to have some areas of the report reversed, but ultimately accepted the DSB's

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<sup>227</sup> [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds99\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds99_e.htm)

<sup>228</sup> [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds296\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds296_e.htm)

<sup>229</sup> Agreement on Subsidies and Countervailing Measures, the WTO. Article 15.5 of the agreement specifies that a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities.  
[http://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](http://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

recommendations for implementation within a reasonable period of time. It was on 7 November 2005 that South Korea and the U.S. had mutually agreed on a timeline for implementation by the U.S. by 8 March 2006.

The cases on agriculture and semiconductor chips demonstrate South Korea's reciprocal approaches to WTO disputes. South Korea's methods in pursuing a WTO case as a complainant and a respondent stem from both a pragmatic idea that it is important to fully utilize available institutions and means at hand (if it can save itself from industrial losses by doing so), and a political agenda that seriously considers the conglomerates of South Korea, by which a large part of the South Korean elite and semi-elite population is employed. In the face of the weakening agricultural sector, the South Korean Presidency and the bureaucracy understand very well that public opinion matters greatly for political survival.<sup>230</sup> Such concerns by the incumbents influence the policymaking process, particularly in the case of South Korea's defensive sectors.

## China

### *China's Trade Imbalances with the U.S. and WTO cases*

U.S. trade deficits with China widened from the late 1990s and at a much faster pace since China's entry to the WTO in 2001 (see **Figure 4-8**). When China opened its doors

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<sup>230</sup> In a national experts survey conducted by the East Asia Institute in October 2004, results showed that South Korean perceptions toward the WTO are quite favorable (56.2 percent of the respondents replied favorably to the role of the WTO), and that the South Korean public adheres to the rulings by the WTO DSB (83.7 percent of the respondents replied that South Korea should adhere to WTO rulings even if the ruling is not favorable to South Korea's economic interests). See '2004 국제관계에 대한 여론조사', 동아시아연구원, [http://www.eai.or.kr/data/bbs/kor\\_report/2009092115551241.pdf](http://www.eai.or.kr/data/bbs/kor_report/2009092115551241.pdf). Nonetheless, WTO rulings or dispute initiations that target South Korea's defensive sectors like agriculture can provide negative repercussions to the incumbent ruling party, and there are reports by South Korea's think tanks that openly express their concerns that adhering to the WTO ruling may call for protests by the opposition party and may stir public opinion. (See *Korea-Canada Beef WTO Dispute Prospects*, Korea International Trade Association 한-캐나다 쇠고기 분쟁 전망, 한국무역협회, July 2009.)

for foreign direct investment, many U.S. industries relocated their manufacturing bases to Mainland China for cheap labor cost and further opportunities. Some U.S. industries saw the fast accumulation of trade deficits with China as a credible threat to their interests, and the number of petitions to the USITC, USDOC, and the USTR skyrocketed as China's economy grew over time. Within the U.S. domestic political arena, policymakers found it increasingly difficult to disassociate themselves with industrial concerns and lobbying regarding loss of jobs, and often found the root causes in China. While U.S. public sentiment was geared toward placing the blame on China, or bashing China, alternative explanations were given to suggest that despite the widening U.S. trade deficit with China, the value added for the Chinese economy was fairly minimal due to its centralized function for final assembly rather than research and development.<sup>231</sup> The U.S. International Trade Commission has also found that attributing the entire export value to the last exporting country can provide a misleading picture of the sources of value in U.S. trade, and that examinations of bilateral trade balances on a value-added basis yield different conclusions about the extent to which a country may generate U.S. trade deficit. China is a final assembler and it mainly uses components from abroad to produce its export goods. The U.S.-China trade deficit on a value-added basis is considerably smaller than on the official gross trade.<sup>232</sup> This is a big contrast from the case of U.S.-Japan trade, in which Japanese companies export parts to their own assembly plants overseas and then export the final products to the U.S. The U.S.-Japan trade deficit on a value-added basis

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<sup>231</sup> Yuqing Xing and Neal Detert, 'How the iPhone widens the U.S. Trade Deficit with the People's Republic of China', the Asian Development Bank Institute, 2010.

<sup>232</sup> Mason and Russell, 2013. p.75.

is larger than the comparable gross trade deficit. In a sense, the general public sentiment or political outcry against Chinese threat on the U.S. economy based on trade deficits could be misleading if we focus on the value-added trade figures. In conversing with China's economists or political scientists, one can easily sense that the Chinese regard U.S. bashing against China as unjust if we only look at value-added trade, and that based on the figures of value-added trade, they think the degree of pressures on China is too harsh in comparison to the previous pressures on Japan.<sup>233</sup>

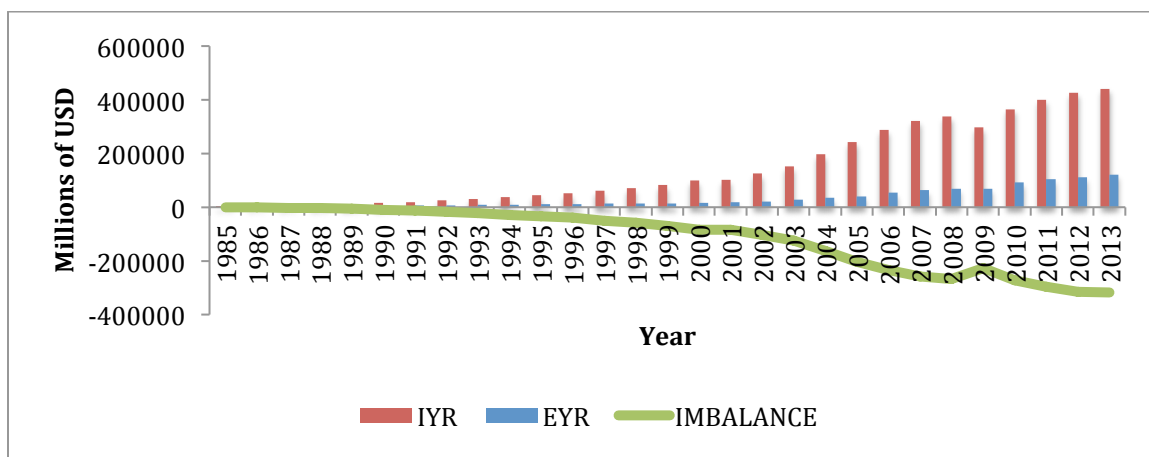
At a glance, China's generation of trade surpluses with the U.S. may seem like a repetitive pattern. The recurring cycles of U.S. protectionist measures are indeed there, and it is a fact that the U.S. public and policy makers are conscious about resolving trade deficit issues with China. But the dimensions of the trade conflict are more complex than previous cases of other East Asian countries in past decades. Due to the interconnectedness of the two economies and the strategic rivalry and conflict concerning security issues (i.e., North Korea, Taiwan) that complicate the diplomatic communication between the two countries, it is very difficult for the U.S. to simply resort to trade sanction tactics only. The U.S. understands very well that in order to gain the most out of its relationship with China, it must use a carrot-and-stick approach to bring out the changes from China from within (i.e., on protection of intellectual property or on fair trade). The complexity of the U.S.-China relationship (i.e., economic interdependence, security issues) puts China in a position in bilateral negotiations with the U.S. in which

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<sup>233</sup> Personal interviews.

China can afford to say no to defend its primary interests, or give the U.S. the cold shoulder to U.S. requests or pressures.

**Figure 4-8. U.S.-China Trade Imbalances (1985-2013)**



Source: U.S. International Transactions Accounts Data, Bureau of Economic Analysis

#### *China's Institutionalism in WTO Dispute Participation*

In the initial years of its WTO membership, China was rather inactive as a complainant or a respondent, and instead focused on learning the procedures of the WTO DSB as a newcomer and on accumulating legal expertise via third party participations cases that it is not directly involved in. From the years 2003 to 2007, China acted as a third party to virtually every panel established during that time period, and learned the views of the Panel and the Appellate Body.<sup>234</sup> The following year after gaining WTO membership, it sought to participate in as many cases as possible as a third party (see **Figure 4-9**). As the years progressed, China has been targeted more from other member states, and it found its interest in reversing its passive position to active pursuer of disputes in the WTO. Over the past decade, China has indeed become a primary target in

<sup>234</sup> Ewing-Chow, Goh, and Patil, 2013.

the WTO DSB, owing to its violations of the WTO agreement, with the background of political concerns regarding China's exports in its trading partner countries. Currently, China's large trade surplus exacerbates the likelihood of rising tensions in trade disputes between China and its trading partners. In turn, China has been transforming itself into an active litigant. Today, China mobilizes all of its industrial and governmental efforts to defend its interests via the WTO dispute settlement process.

Currently, China's MOFCOM is the main institution that carries out all WTO related matters. As it saw the increasing need to defend its interests in the WTO, China reorganized its bureaucratic functions on trade matters by transforming the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) into MOFCOM in 2003.<sup>235</sup> In the initial stages, within the MOFCOM, the WTO Affairs Department dealt with WTO negotiations, complemented by the WTO Legal Affairs Division within the Department of Treaty and Law that handles WTO dispute cases. The MOFCOM's mandate is approved by the State Council, and the Minister of MOFCOM decides whether a case is to be pursued or not in the WTO, while the Premier or Vice Premier in charge of foreign trade matters within the Politburo is ultimately responsible for exercising influence on the final decision.

In the year of 2009, China saw greater interest in expanding its legal capacity in the WTO, and within the MOFTEC, a second legal team was set up in addition to the WTO Legal Affairs Division within the Department of Treaty and Law, which previously had

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<sup>235</sup> Shaffer and Meléndez-Ortiz eds., 2010. p. 163.

to handle all the workload on WTO cases.<sup>236</sup> In late 2009, the Chinese government made a decision to post a top international trade expert in Geneva, bolstering the legal capacities of the WTO mission. China does still face difficulties acquiring competent legal personnel for WTO disputes from its own citizens, and has had the practice of hiring bilingual overseas Chinese lawyers with law degrees from the U.S. and Europe.<sup>237</sup> Nonetheless, beefing up the legal capacity for WTO disputes enabled China to adjudicate in the WTO DSB with more personnel and resources, and also led to the increase of China's complaints, let alone responses and third-party participations. The exponential increase in cases involving China in the WTO is one factor that makes it seem proactive in comparison to its neighbors Japan and South Korea (see **Table 4-1**).

One critical issue regarding China's behavior patterns in WTO disputes is about its willingness and capacity for implementation after Panel recommendations have been delivered. Given the difficult environment for regulation, WTO DSB recommendations may not directly lead to China's domestic policy implementation. The lack of inter-governmental policy coordination is also a factor that contributes to the more hurdles to implementation.<sup>238</sup> When conflicts arise regarding implementation of WTO recommendations, the Vice Premier in charge of foreign trade affairs intervenes, but coordination among the ministries will be viable only if the ministries in question fall under the Vice Premier's responsibilities. In other words, the top-down, hierarchical system functions well only if the higher and subsidiary actors are within the matching

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<sup>236</sup> Ewing-Chow, Goh, and Patil, *ibid.*

<sup>237</sup> Personal interviews with a Peking University professor who has acted as adviser to the MOC for WTO dispute cases.

<sup>238</sup> Shaffer and Meléndez-Ortiz eds., *ibid.*

boundaries of power. For instance, resolution of a case on antidumping duties required cooperation from the customs bureau, which did not want to cooperate, and the State Economic and Trade Commission (SETC), which used to be responsible for injury determination. In order to lessen the complexities in bureaucracy, the Department for Industrial Injury merged with the MOFCOM. Some provincial governments with intensive trade and investment have also established matching institutions.<sup>239</sup> The fragmentation of authority among the Chinese ministries remains a big barrier to achieving greater efficiency toward China's actions in the WTO.

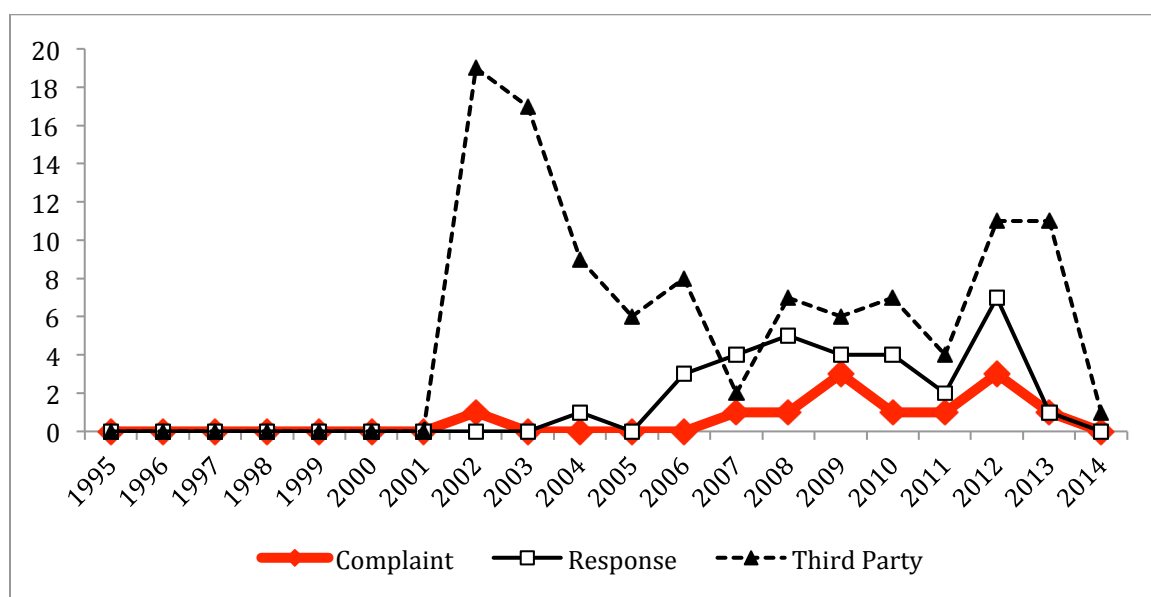
Moreover, the strong national government with its hierarchical system makes it difficult for the industries and the civil society to be engaged with WTO issues and hinders business-government coordination. Contrary to the U.S. case, in which petitions from industries flood in and industrial lobbying is commonplace in the U.S. Congress, in China it is actually the government rather than the industries that has the upper hand and actual power in pursuing cases in the WTO. Many of China's industries that are blooming with potential are strategically developed, and state-owned enterprises (SOEs) are still under the auspices of the central government. As discussed in Chapter 3, China's trade remedy system is driven mainly by the MOFCOM than the industries themselves. Once the MOFCOM decides to pursue trade remedy investigations in a certain industry, they leave the hands of the industry people entirely. Therefore, cases that spring from strong commercial pressures have not been the norm in the Chinese cases. Furthermore, while the Chinese public understands very well the effects of entering the world economy

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<sup>239</sup> Wang Yong in Matsushita and Ahn eds., 2004. p.304.

(入世, *ru shi*) and may be aware of WTO cases via news reports, the public is not yet equipped with the political intent or power to voice their opinions or mobilize themselves to defend their own interests. Thus, China's decision-making process toward WTO dispute participation remains strictly governmental.

**Figure 4-9. China's Participation in the WTO (1995-2014)**



Source: [www.wto.org](http://www.wto.org)

**Table 4-8. U.S.-China Cases in the WTO DSB (1995-2013)**

Case #	U.S. Complaint against China	Case #	U.S. Responses to China	Case #	U.S. as Third Party in cases involving China
DS309	Value-Added Tax on Integrated Circuits (March 2004)	DS252	Definitive Safeguard Measures on Imports of Certain Steel Products (March 2002)	DS395	China - Measures Related to the Exportation of Various Raw Materials (Complainant: European Communities)
DS340	Measures Affecting Imports of Automobile Parts (March 2006)	DS368	Preliminary Anti-Dumping and Countervailing Duty Determinations on Coated Free Sheet Paper from China (September 2007)	DS397	European Communities - Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China (Complainant: China)
DS358	Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments (February 2007)	DS379	Definitive Anti-Dumping and Countervailing Duties on Certain Products from China (September 2008)	DS398	China - Measures Related to the Exportation of Various Raw Materials (Complainant: Mexico)
DS362	Measures Affecting the Protection and Enforcement of Intellectual Property	DS392	Certain Measures Affecting Imports of Poultry from China (April 2009)	DS405	European Union - Anti-Dumping Measures on Certain Footwear from China (Complainant: ...)

	Rights (April 2007)				China)
DS363	Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products (April 2007)	DS399	Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China (September 2009)	DS425	China - Definitive Anti-Dumping Duties on X-Ray Security Inspection Equipment from the European Union (Complainant: European Union)
DS373	Measures Affecting Financial Information Services and Foreign Financial Information Suppliers (March 2008)	DS422	Anti-Dumping Measures on Shrimp and Diamond Sawblades from China (February 2011)	DS432	China - Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum (Complainant: European Union)
DS387	Grants, Loans and Other Incentives (December 2008)	DS437	Countervailing Duty Measures on Certain Products from China (May 2012)	DS433	China - Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum (Complainant: Japan)
DS394	Measures Related to the Exportation of Various Raw Materials (June 2009)	DS449	Countervailing and Anti-dumping Measures on Certain Products from China (September 2012)	DS454	China - Measures Imposing Anti-Dumping Duties on High-Performance Stainless Steel Seamless Tubes from Japan (Complainant: Japan)
DS413	Certain Measures Affecting Electronic Payment Services (September 2010)	DS471	Certain Methodologies and their Application to Anti-Dumping Proceedings Involving China (December 2013)	DS460	China - Measures Imposing Anti-Dumping Duties on High-Performance Stainless Steel Seamless Tubes from the European Union (Complainant: European Union)
DS414	Countervailing and Anti-Dumping Duties on Grain Oriented Flat-rolled Electrical Steel from the United States (September 2010)				
DS419	Measures concerning wind power equipment (December 2010)				
DS427	Anti-Dumping and Countervailing Duty Measures on Broiler Products from the United States (September 2011)				
DS431	Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum (March 2012)				
DS440	Anti-Dumping and Countervailing Duties on Certain Automobiles from the United States (July 2012)				
DS450	Certain Measures Affecting the Automobile and Automobile-Parts Industries (September 2012)				

Source: WTO

*China's WTO Cases with the United States*

The U.S. has filed cases against China on a broad range of goods and services. On goods, the focus has been primarily on steel, automobiles in parts and whole, and raw materials like rare earths. Two cases – one on China's measures on intellectual property (DS362), in which China prevailed; and the other on China's measures on publications and audiovisual entertainment products (DS363), in which China lost – are quite reminiscent of the case on Japan's sound recording case in 1996 (DS28). Also eye-catching were the U.S. cases on China that focused on services other than tradable goods, such as those involving China's measures on financial services and electronic payment.

After its accession to the WTO, China had been facing tremendous bilateral pressure from the U.S. and the EU on its enforcement of intellectual property. The U.S. filed a WTO complaint on *China - Measures Affecting the Protection and Enforcement of Intellectual Property Rights (DS362)* in April 2007. Filed alongside the case was a U.S. complaint on *China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*. These two cases were salient cases in which vital interests in the U.S. economy clashed with those of China's, and in which China defended itself quite well, leaving the U.S. dissatisfied with the results of the Panel ruling. Prior to the WTO dispute initiation, in April 2005, the USTR in its released out-of-cycle review on China had raised grave concerns on IPR protection and enforcement.<sup>240</sup> Based on this report, China was placed back on the Priority Watch

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<sup>240</sup> Office of the U.S. Trade Representative, Out-of-Cycle Review Results, Washington, D.C., April 2005.

List for the first time since its accession to the WTO.<sup>241</sup> The USTR did not file a complaint that year, but ultimately filed two IPR relevant cases two years later. In DS362, the U.S. raised the following important concerns: 1) China's Criminal Law and related Supreme People's Court interpretations that establish thresholds for criminal procedures and penalties for infringements of IPR; 2) China's Regulations for Customs Protection of Intellectual Property Rights and related Implementing measures that govern the disposal of infringing goods confiscated by customs authorities; and 3) Article 4 of China's Copyright Law, which denies protection and enforcement to works that have not been authorized for publication or distribution within China.<sup>242</sup> In DS363, the U.S. raised concerns regarding 1) measures that restrict trading rights with respect to imported films for theatrical release, audiovisual home entertainment products, sound recordings and publications; and 2) measures that restrict market access for foreign suppliers of distribution services for publications and audiovisual services.<sup>243</sup> China appealed against Panel rulings in both cases and was able to turn the Panel findings around partially, pleading that it needed more time as domestic implementation would be difficult in a short amount of time. In both cases, despite China's reporting to the WTO DSB that it had taken the steps for implementing the DSB recommendations, the U.S. response was reluctant to acknowledge China's implementation.<sup>244</sup> Finding that it is difficult to acquire

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<sup>241</sup> Peter Yu, 'The First Decade of TRIPS in China', in Ka Zeng and Wei Liang eds., *China and Global Trade Governance: China's first decade in the World Trade Organization*, 2013. pp.126-143.

<sup>242</sup> [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds362\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds362_e.htm)

<sup>243</sup> [http://wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds363\\_e.htm](http://wto.org/english/tratop_e/dispu_e/cases_e/ds363_e.htm)

<sup>244</sup> In DS362, China reported to the WTO DSB that the Standing Committee of the 11<sup>th</sup> National People's Congress had approved the amendments of the Chinese Copyright Law on February 26, 2010, and that the State Council had adopted the decision to revise the Regulations for Customs Protection of Intellectual Property Rights on March 17, 2010.

what it seeks for China's IPR implementations pushed the U.S. policymakers toward opting for a negotiation framework in the TPP that emphasizes the components of IPR. Thus, the U.S.-China debate on IPR will likely continue into the future.

China's retaliatory approach to trade wars was most highlighted in the U.S.-China trade disputes on chicken and tires in 2009, the year that the two countries' trade conflicts turned very intense. When the United Steel Workers of America petitioned for and was granted a special safeguard by the USITC in early 2009, the case received further attention via the USTR's holding of hearings and submissions of recommendations to President Obama in September 2009. In turn, on September 11, 2009, the Obama Administration announced 3 years of punitive duty on Chinese tires for three years. In response to this measure, the MOFCOM embarked on an antidumping and countervailing duty investigation on U.S. automobiles and poultry.<sup>245</sup> The cases moved stage to the WTO in which the two countries clashed in two cases: China's complaint on *U.S. Measures Affecting Imports of Poultry from China (DS392)*, and China's complaint on *U.S. Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China (DS399)*. In DS392, China questioned the Section 727 of the Agriculture Appropriations Act of 2009, which prohibited the use of funds to establish or implement a rule allowing Chinese poultry products to be imported into the U.S. Despite the Panel's findings of several U.S. violations, it did not recommend the U.S. to bring Section 727 into conformity with its obligations under the SPS agreement and the GATT, because Section 727 had already expired by the time of the Panel's ruling. In DS399, China

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<sup>245</sup> <http://money.163.com/special/00253JQE/zmlt.html>

brought the DSB's attention to U.S. transitional product-specific safeguard measure applied to certain passenger vehicle and light truck tires from China under Paragraph 16 of China's Accession Protocol pursuant to Section 421 of the U.S. Trade Act of 1974. China did not prevail in either of the cases, and two years later, the U.S. filed a complaint on Chinese poultry barriers, *China - Anti-dumping and countervailing duty measures on broiler products from the United States (DS427)*. The U.S. questioned MOFCOM's antidumping and countervailing duty impositions on U.S. broiler products, and ultimately the Panel ruling provided DSB recommendations for China to implement. The U.S. won nearly every component that it requested for in the case.<sup>246</sup>

Although China has not won every case that it has brought to the WTO DSB, it has certainly made its presence visible in the DSB via bringing complaints and responding to complaints in a retaliatory and defensive manner. Retaliation by China is reflected in the ways that China would pursue a case in a sector different than the sector that was originally targeted to counter the pressures, and is seen in the cases on chicken and tires. Defensiveness in China's responses to the WTO dispute initiations is most salient in the case of its defensive sector, as seen in the case of IPR. Its presence is marked in such a way that its voice would be heard by other member states and that it would draw the attention of other member states. With an expanded legal personnel within the MOFCOM and the Vice Premiership supporting and supervising the MOFCOM with regard to China's WTO dispute initiations, China's institutional mechanisms toward a WTO

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<sup>246</sup> The U.S. Trade Representative Press Release, August 2013. 'United States Wins Trade Enforcement Case for American Farmers, Proves Export-Blocking Chinese Duties Unjustified Under WTO Rules'. <http://www.ustr.gov/US-Wins-Trade-Enforcement-Case-AmericanFarmers-Proves-Export-Blocking-Chinese-Duties-Unjustified-Under-WTO-Rule>

dispute embodies a government decision-making process that enables the fiercest litigation possible amongst the three countries of East Asia.

### **Conclusion**

U.S. dispute initiation in the WTO has always started from industrial losses and concerns that led to petitions to the USITC or USDOC and ultimately, the USTR, backed by congressional political lobbying. Sectoral trade shifts or import surges were factors that would serve as catalysts to the rising concerns and heated debates on the chronic U.S. trade deficit issue. The overall assessment of dispute settlement cases filed under the WTO DSB reveals the variation among the three countries in response to U.S. protectionist measures via dispute initiation. First, Japan is the most reluctant and acquiescing litigant despite its developments of WTO adjudication over time in comparison to the GATT periods and increasing participation as a third-party for collecting info and exchanging views. Second, South Korea is the reciprocal litigant that seeks for opportunities to win, and pursues cases against the United States more than Japan does, but not as aggressively as China does. Lastly, China, on the other hand, fairly new to the international trade disputes compared to the two other countries, has become the main target in the 2000s and 2010s upon WTO accession. This is a cyclical pattern owing to the generation of U.S. trade deficits and concerns arising from the U.S. industries and governmental actions.

## CHAPTER FIVE

### Currency Conflict: East Asian Responses to U.S. Currency Appreciation Pressures, 1971-2013

“The dollar would have to fall further to reduce the United States' widening trade deficit if Japan and West Germany did not lower their interest rates.”  
-James Baker III, Former U.S. Secretary of Treasury, 1986-

“The Treasury began discussions with Korea on the matter of currency in the latter part of 1986 when it became obvious after the Plaza Agreement that the currency adjustments that were taking place among the major currencies were not being followed by certain other countries, including Korea. Our efforts met with little success.”  
-David Mulford, Former U.S. Under Secretary of International Affairs for the Department of Treasury, 1989-

“If China does not allow the currency to appreciate more rapidly, it will run the risk of seeing domestic inflation accelerate and face greater risk of a damaging rise in asset prices, both of which will threaten future growth.”  
-Timothy Geithner, Former U.S. Secretary of Treasury, 2011-

### **The Recurring Cycles of U.S. Currency Appreciation Pressures**

This chapter is an investigation of the institutional factors contributing to each country's responses to currency appreciation pressures; another component of U.S. protectionist pressures following trade frictions. As reflected in the previous chapters (Chapters 3 and 4), the task of process-tracing the sources of U.S.-Northeast Asian trade conflicts in the past decades is quite meaningful in that such analyses shed light on past decision making behaviors by the three countries, and thus provide policy implications for the present. Meanwhile, analyses of responses to trade conflicts would be incomplete without incorporating information gleaned from the analyses on each country's responses to currency conflicts.

In macroeconomics, exchange rates are expectations about future inflation and interest rates, and reflect expectations about changes in interest rates. Interest rates set by countries (their central banks) can influence exchange rates. When a country's interest rates are raised, investors' capital flows to the country for better returns, and in turn the country's local currency becomes more highly in demand, resulting in exchange rate appreciation. Raising exchange rates reduces the export demand for the country's commodities as they are denominated in the local currency that became relatively expensive, thus resulting in a lower output in the country's overall exports. On the other hand, when a country is expected to lower its interest rates, capital outflow occurs by investors who seek better returns elsewhere, resulting in low exchange rates. Lowering interest rates tends to lead to rises in a country's export demand and higher output in overall exports due to the lower prices of its exports and higher price for imports. Under

the post-Bretton Woods dollar standard, there has been an inevitable interconnectedness between a country's performance in exports and the value of its local currency against the dollar. The cheaper (in real terms) a local currency is vis-à-vis the dollar as an anchor, the more competitive a country's product will be.

Nonetheless, the point of the argument in this chapter is not to suggest that deliberate alternations in exchange rate policies could have brought solutions to the mounting U.S. trade deficits with the three countries in the past. Resolving the trade deficit challenge is a different question, requiring more than a simple twist in the exchange rates. As the subsequent case analyses reveal, a change in the exchange rates does not automatically resolve trade imbalance issues in the longer term. This has been clearly demonstrated in the cases of the three East Asian countries under consideration in this dissertation. The reason is that other factors play a critical role in trade dynamics, *i.e.*, savings patterns, the structure of exports and imports by sector, and patterns of bilateral investment to the counterpart country. Moreover, competitiveness is not solely defined by price, but also quality, the structure of the intra-industrial market, and patterns of consumption. Although the resolving bilateral trade imbalances is a crucial policy assignment for both the U.S. and its trading partners, resolving U.S. trade imbalances will not be central to the discussions in this chapter.

Rather, the scope and argument of this chapter covers the three countries' varied responses in their exchange rate policies. Relying on the institutional framework (Chapter 2), it analyzes why the three export-led economies of Northeast Asia – Japan, South Korea, and China – have shared similar experiences of currency appreciation pressures

from the U.S., albeit in different magnitudes, but came up with different policy responses with regard to a currency conflict with the U.S. In parallel with the patterns of decision-making behavior on trade wars (Chapters 3 and 4), I argue in this chapter that the different institutional patterns of policy decision making also played a significant role in bilateral currency conflicts. What each country chose to do was clearly a reflection of their political capacity and industrial interests. What ultimately contributed to each country's final policy decision was the varying institutional differences in the ways of decision-making, each at pivotal points in time throughout each bilateral economic relation with the United States.

#### **Flashback – '1971 Nixon Shock'**

The global financial system as we see it today has evolved from several critical junctures in history. The gold standard, first been adopted by the British in 1918, was quite stable until WWI, during which nations printed money in order to back their defense spending and floating exchange rates were in operation. After WWI, from about 1919, the world suffered from hyperinflation as a side effect of printing money during wartime. Against this backdrop, the U.S. and the U.K. reverted to the gold standard in 1925, but the Great Depression of 1929 led states to deploy protectionist measures via levying high tariffs and also to begin competitive devaluation of their currencies. By 1931, the gold standard was dysfunctional. The WWII from 1939 left the global financial system in disarray, and just before the war ended in 1945, the superpowers gathered in Bretton Woods of New Hampshire in the U.S. to peg the U.S. dollar at 35 dollars to an ounce of gold and to establish the International Monetary Fund, creating the Bretton

Woods System. Until 1971, the U.S. dollar under the gold-dollar system established at Bretton Woods would enable the U.S. dollar to be backed by gold. It was deemed a plausible idea at the time.

The U.S. economy underwent the golden age of economic growth after WWII. Post WWII, the U.S. spent astronomical amounts of money on providing aid to countries recovering from war, in order to solidify its presence as the leading democratic nation in the world against the Communist bloc during the Cold War. Japan, South Korea after the Korean War, Taiwan, and Western Germany were among many that received U.S. financial support and development aid, but while the U.S. dollar was welcomed everywhere, the U.S. was depleting its dollars and dollars were becoming commonplace all over the world. During this time in the 1950s and 1960s, East Asian economies and countries of Western Europe succeeded in rebuilding their economies, in part owing to the aid received from the U.S. The post-WWII economic boom and expansion was clearly visible in many parts of the globe, including the U.S.

The period of inflation in the U.S. economy from mid- to late-1960s also contributed to difficulty for other currencies to fluctuate to reflect the shift in relative macroeconomic conditions between the U.S. and other nations.<sup>247</sup> Furthermore, U.S. defense spending in the Vietnam War from 1965 to 1975 and increased spending on domestic social programs would serve to be detrimental to the U.S. economy at a later point in time. Economist Robert Triffin's previous assertion in the 1960s that the dollar under the gold-dollar system would face dilemmas of liquidity and credibility proved to be true, as despite

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<sup>247</sup> FedPoint 'Currency Devaluation and Revaluation', the Federal Reserve Bank of New York, September 2011. <http://www.newyorkfed.org/aboutthefed/fedpoint/fed38.html>

demand for the dollar was on the rise, gold production was limited, and as supply of the dollar increased to provide liquidity, the value of the dollar would fall, thus causing it to lose credibility.<sup>248</sup>

By the late 1960s, members of the Bretton Woods system were growing skeptical of the dollar-gold convertibility, and declined to have their local currencies devalued in order to sustain the value of the dollar. In the early half of 1971, Germany, Switzerland, and France exchanged significant amounts of their dollars to gold, and left the Bretton Woods system.<sup>249</sup> By August of 1971, the U.S. had no options left but to declare the end of dollar-gold convertibility. Domestic conditions were worsening - unemployment (6.1%) and inflation rates (5.84%) were fairly high as U.S. policymakers sought to find a solution to save the dollar. On August 15, 1971, then U.S. President Nixon announced that the U.S. would abandon the dollar's convertibility to gold, which resulted in the breakdown of the Bretton Woods System. In December 1971, the Group of Ten (G-10) signed the Smithsonian Agreement, in which they decided to appreciate their local currencies against the dollar and to allow a modest devaluation of the dollar to \$38 per ounce, and thus a new set of parities that reflected revaluation of other currencies against the dollar was set in place.<sup>250</sup> In 1973, fixed exchange rates at the global level were abandoned altogether, and the IMF Board of Governors approved modifications in the IMF Charter that reflected this change in 1976, making the amendments effective from

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<sup>248</sup> Triffin, Robert, 'Gold and the Dollar Crisis; the Future of Convertibility', Yale University Press, 1961.

<sup>249</sup> Eichengreen, 2010.

<sup>250</sup> The Group of Ten, or the G-10 countries was the group of countries that agreed to the General Agreements to Borrow (GAB), established in 1962. In addition to the eight IMF member countries – Belgium, Canada, France, Italy, Japan, the Netherlands, the U.K., and the U.S. – Germany and Sweden also joined the Group of Ten.

1978.<sup>251</sup> Since 1973, exchange rates for most industrialized countries have either floated or fluctuated against the dollar according to the supply and demand of international currencies in the global economy. The adoption of the floating exchange rate system by economies around the world did not end currency conflicts, however; indeed, it the monetary history of the ensuing decades has been marked by repeated conflicts over exchange rates and currency policies.

Subsequent events after the Nixon Shock would render the U.S. economy very fragile. The Nixon Shock was the beginning of speculative patterns against the dollar around the world. The Oil Shocks of 1973 and 1976 added fuel to the fire. Without a doubt, the dollar standard had been a fundamental element of the structure of post-WWII exchange rates and international currency transactions in the global economy. Under the non-fixed, floating exchange rate system, nobody was in charge.<sup>252</sup> The process of globalization did so much more than just simple currency exchanges. The U.S. spearheaded the direction of globalization, pushing for market access overseas, first via trade liberalization, and as time passed, financial liberalization. In this process, the U.S. kept a keen eye on the developing states of East Asia. Each major trading partner at the height of its economic development would come under scrutiny by the U.S. authorities with regard to its trading patterns and exchange rate policies.

### **U.S. Currency Appreciation Pressures**

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<sup>251</sup> 'Articles of Agreement of the International Monetary Fund', the International Monetary Fund. <http://www.imf.org/External/Pubs/FT/AA/index.htm#a19s7>

<sup>252</sup> Paul Volcker, then Chairman of the U.S. Federal Reserve Board, was quoted as saying that "Nobody is in charge." CITATION??

Following the Nixon Shock and its impacts on the U.S. economy throughout the 1970s, the increase in U.S. trade deficits prompted U.S. officials to take policy actions on its trading partners not solely via the policy tools of trade remedy, but also via demanding its trading partners carry out currency appreciation, domestic demand expansion, and financial liberalization. With a large and growing bilateral trade surplus with the U.S., Japan became the primary target of criticism from the 1970s and 1980s. South Korea became a central concern along with Taiwan for similar reasons in trade dynamics from the latter half of the 1980s, and China has become the major target in the past decade since its 2001 WTO accession. The crucial points in the similarities of U.S. pressures imposed on the three countries lie in the U.S. concerns for its domestic industry interests. U.S. protectionist pressures would be imposed initially in the forms of trade pressures (i.e., further market access, levy of tariffs, trade remedies consisting of USITC investigations or WTO dispute initiations), but pressures on trade were often times not accompanied by immediate effects in decreasing U.S. trade deficits. Scrutinizing undervalued currencies would naturally become a serious task for the U.S. Treasury, and thus the U.S. Treasury actively approached and held bilateral talks concerning its request for currency appreciation with all of the three countries at different time periods (**Table 5-1**).

**Table 5-1. Major U.S.-Northeast Asia Currency Conflicts and Country Responses**

Responses	Japan	South Korea	China
1970s	1971 August 15 Nixon Shock December 'G10' Smithsonian Agreement		
1980s	1983 Reagan-Nakasone Summit	1986 U.S. Treasury holds discussions with	

	<p>Meeting, Tokyo November 9-12</p> <p><b>1984</b> Yen-Dollar Committee Meetings 1st: February 23-24, Tokyo 2nd: March 22-23, Tokyo 3rd: April 16-17, Washington 4th: May 6, Honolulu 5th: May 12-13, Tokyo 6th: May 20-22, Rome</p> <p><b>September 22, 1985</b> <b>'G5' The Plaza Accord</b> Japan reevaluates the yen against the dollar.</p> <p><b>1986</b> April 3 Japan intervenes in the FX market April 8 Takeshita-Baker Meeting May 13 Baker Statement September 6 1st Miyazawa-Baker Meeting September 26 2nd Miyazawa-Baker Meeting October 31 Miyazawa-Baker Statement</p> <p><b>1987</b> January 21 Miyazawa-Baker Emergency Meeting January 28 U.S. Intervention in the FX market February 22 'G5' Louvre Accord</p> <p><b>1988</b> January 4 Yen reaches peak after Plaza January 13 Takeshita-Reagan Meeting Joint FX interventions</p>	<p>South Korea (MOF) on the matter of currency after the Plaza Accord</p> <p><b>1988</b> Currency Appreciation Pressures on the South Korean won by the U.S. Treasury and the IMF February 1988 March 1988</p> <p><b>1987</b> <b>IMF Pressures on financial liberalization</b> July 1987 Korea announces no further revaluation but declares plans for further liberalization.</p>	
<b>1990s</b>	<p>There was also pressure on Japan in the 1990s – you can probably find some news reports on Larry Summers' pressure on Japan in spring 1993, as well as public complaints about the weak yen in 1998.</p>	<p><b>1995</b> <b>Accession to the WTO</b> <b>1996</b> <b>Accession to the OECD</b> <b>1997</b> <b>Asian Financial Crisis</b> <b>IMF Stand-By Arrangement</b> Korea faces accidental depreciation in the midst of financial crisis.</p>	<p><b>1994</b> China reevaluates the renminbi.</p>
<b>2000s</b>			<p><b>2001</b> <b>ACCESSION TO THE WTO</b></p> <p><b>2003</b> China reevaluates the renminbi.</p> <p><b>2006-Present</b> <b>U.S.-China Strategic and Economic Dialogue</b> September 21, 2006</p>

			December 15, 2006 May 23, 2007 December 13, 2007 June 18, 2008 December 5, 2008 July 28, 2009
<b>2010s</b>			May 24, 2010 May 9, 2011 May 3, 2012 July 10-11, 2013

*Note: By author based on government records of bilateral dialogues and on selected publications – Takita (2005), Grimes (2001), Flath (2005), and McKinnon (2013)*

After the breakdown of the Bretton Woods System in 1971, the three countries shared similar experiences of streamlining their economies with the rest of the world at different time periods. In order to become a full-fledged economic actor in the global economy, countries were required to accept the global rules and norms, such as the obligations of Article VIII of the IMF Charter, under which a country would be obligated to eliminate its remaining restrictions on payments and transfers for current account transactions, and to refrain from engaging in discriminatory currency arrangements or multiple currency practices without the IMF's approval.<sup>253</sup> Japan accepted Article VIII of the IMF in 1964 and further joined the OECD the same year. South Korea accepted Article VIII of the IMF in 1988, and joined the OECD in 1996. China accepted Article VIII of the IMF in 1996, and has yet to join the OECD but has remained in close partnership with the international organization since 1995. Thinking in different time frames is required in the analysis to be presented in this chapter, but the focus is on the paralleled policy choices of each country at those different time periods. How and why each country embraced the pressure from abroad toward economic opening and acceptance of global economic norms will help us to understand under what domestic circumstances and objectives the

<sup>253</sup> Section (2) Avoidance of restrictions on current payments and Section (3) Avoidance of discriminatory currency practices, 'Article VIII: General Obligations of Members', IMF Charter. Current modified version adopted April 28, 2008. <http://www.imf.org/External/Pubs/FT/AA/index.htm#art4>

domestic policy makers of each country made their decisions in response. Aside from the institutional factors that remain the main pillars of the analysis in this chapter, process-tracing the country actions taken toward exchange rate policies will involve a careful examination on the countries' policies on interest rates, which directly affect exchange rates.

### **Revisiting Institutional Variance – Japan, South Korea, and China**

A closer examination at the bureaucratic and decision-making structures in each of the countries is the key to the analysis of institutional variance and its effect on policy responses (Chapter 2). At each event of currency appreciation pressures, it was up to the bureaucracies of each country to decide on how to cope with the pressures from outside. After specific negotiations with the U.S. Treasury, the bureaucrats of the three countries would also be responsible for coming up with strategies to deal with each of the concerns that were addressed to them. The institutional variance among the three countries arose from the differing degrees of policy coordination amongst the ministries, and also the sources of power in a specific area of the bureaucracy. In other words, who had the stronger say in macroeconomic politics in each of the financial bureaucracies of Japan, South Korea, and China, would present their positions in the most diplomatic yet strategic manner possible.

In this chapter, I first take the cases and time periods of the most relevant and appropriate that fall into the categories of the most severe U.S.-Northeast Asian clashes on currency – Japan from 1985 to 1993, South Korea from 1988 to 1989, and China from 2003 to 2013. The objective in the comparative analysis of later time periods is to derive

implications for policies today and to project into the immediate and longer-run future. While the U.S. pressures to liberalize each of the three countries' financial and capital markets occurred in parallel with pressures to appreciate the local currencies, the differing policy choices in the face of U.S. pressures for financial liberalization are laid out separately in Chapter 6. Although currency and finance are interrelated, and the issues were by and large concurrent, the negotiations on each issue occurred in separate dialogues. Therefore, I divide the issues of negotiations on currency appreciation and financial liberalization to closely examine the actions of policy makers and relevant ministries in the three countries. In the case of Japan and South Korea, financial opening negotiations or pressures occurred prior to currency negotiations.

The point of argument in this chapter is that the varying pathways of policy responses were generated by different decision makers - politicians and government officials who belong to different settings of policy decision making in each country. In the case of Japan, the negotiations on Japanese yen appreciation during the Plaza Accord occurred when the Ministry of Finance was its most powerful within the bureaucratic system (more powerful than the Diet and the Bank of Japan before the revision of the Bank of Japan Law in 1998). In the case of South Korea, the powerful presidency was the principal and the Ministry of Finance (currently the MOSF) was the agent in the series of trial-and-errors in macroeconomic strategy, which escalated to sudden depreciation of the KRW in the Asian Financial Crisis of 1997. Lastly, but as the most recent and hotly debated, the Chinese case presents a very top-down, hierarchical decision-making process

involving the State Council and the Leading Group of Financial and Economic Affairs, a selected number of politicians in the Politburo.

### **Japan – Policy Dominance by the Ministry of Finance**

The trade frictions that were ongoing between the U.S. and Japan from the late 1960s served as the grounds for U.S. pressures on Japanese currency appreciation in the early part of 1980s. Japan had already gone through a series of voluntary export restrictions (VER) on its textiles, automobiles, and machinery, but limiting the amount of exports did not solve the issues of trade balance. The effects of VERs bounced back. In the case of automobiles, because the export restraints compelled METI (then MITI) to assign each manufacturer a maximum allowable number of vehicles to export, the companies naturally tended to export vehicles on which the profit margin was as great as possible, meaning higher quality cars. Moreover, the export restraints raised the American prices of Japanese cars, thereby increasing the demand for American and European cars in America, and inducing rises in their prices.<sup>254</sup> The uproar by U.S. auto producers against the Reagan Administration's March 1985 announcement not to seek renewal of the VERs based on the burdens of rising auto prices on the consumers was a clear reflection of divided interests between manufacturers and consumers in the U.S.<sup>255</sup> In July 1985, the Japanese government made efforts to grant market access to foreign trading partners via adoption of an “action program for improvement of access to Japanese market”, based on

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<sup>254</sup> Flath, 2005.

<sup>255</sup> However, the VER was renewed in 1984 at a cap of 1.85 million units, and was imposed again in 1985 at a raised cap of 2.3 million units. The VER on Japanese automobiles was only finally removed in 1994.

the new basic precept of “Free in principle, restriction for the exceptional case”.<sup>256</sup>

Despite the efforts, the trade imbalance persisted.

As the U.S.-Japan trade frictions culminated in serious political debates in the U.S. Congress in the year of 1985, the real appreciation of the US dollar against the Japanese yen also reached its peak in the same year. The trade frictions in the 1970s provided ample political reason for ‘*Japan bashing*’ in Washington.<sup>257</sup> A catalyst toward the rise of political debate in Washington can be attributed to the Murchison-Solomon Report, which was presented to Washington officials by the former Chairman of Caterpillar Tractor Company, Lee Morgan. Commissioned by Caterpillar, a main competitor for Japanese tractor company Komatsu, and drafted by attorney for Caterpillar, David Murchison, and Stanford professor Ezra Solomon, the report argued that Japan was generating a large part of U.S. trade imbalances, and that the yen-dollar rate was at the crux of the problem.<sup>258</sup> The U.S. was not only pressured by its domestic industries, but also from abroad – other G5 members were complaining about the overvalued dollar.<sup>259</sup>

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<sup>256</sup> ‘White Papers of Japan, 1985-86: Annual Abstract of Official Reports and Statistics of the Japanese Government’, The Japan Institute of International Affairs, 1987.

<sup>257</sup> Nevertheless, Flath addresses an important point that it was the strong dollar, and not the closed Japanese market or unfair Japanese trading practices that resulted in rise of Japanese goods sales in the U.S. market, and inhibited U.S. goods sales in the Japanese market. While the political rhetoric at the time in the U.S. strongly focused on Japanese malpractices in trade, Flath stresses that Japanese yen appreciation in the Plaza Accord of 1985 was a part of global effort to keep the dollar from appreciating so much against other currencies – the British Pound, the French Franc, the German Deutsche Mark. Today, U.S.-Japan trade imbalances persist.

<sup>258</sup> Thorn, 1987. pp.29-30. The Murchison-Solomon report, specified and ordered eleven key factors to be addressed with regard to the yen-dollar rate, and argued that Caterpillar’s efforts to bring production costs under control have been diminished by the weak Japanese yen, which made Caterpillar’s price competition with Japanese products impossible. The report was also later published: ‘The Misalignment of the United States Dollar and the Japanese Yen: The Problem and Its Solution’, *California Management Review*; Fall 1984, Vol. 27 Issue 1, p.42.

<sup>259</sup> Grimes, 2001. p.111.

To fully understand the Japanese policy intent behind bilateral dialogues and interactions with the U.S. at the time, a dissection of the political interests of each of the bureaucratic actors is required (See **Figure 2-3** in Chapter 2). The main players within the Japanese bureaucracy - the PM and his Cabinet (politically appointed), the Diet, MOF, METI, and BOJ could be considered as actors with a political interest within the institutional power struggle. MOFA, which usually engages in diplomatic affairs and security related matters, was mainly involved in trade and energy related discussions with the U.S. (i.e., Abe-Schultz bilateral meeting), intensifying U.S.-Japan relations and giving impetus to currency related negotiations.<sup>260</sup> METI was engaged in providing guidelines with regard to any directions on domestic industries with regard to exports to the U.S.

But of all bilateral issues, MOF would not let the policy agenda on yen-dollar rates fall on the laps of other ministries. MOF officials worked to ensure that matters regarding international finance would be left solely to their discretion prior to intra-ministerial consultations. In the informal MOF-US Treasury bilateral discussions between Beryl Sprinkel, Secretary of Treasury and Makoto Utsumi, Vice-Minister of Finance, Utsumi requested that the negotiations be centralized only between the two ministries – the U.S. Treasury and the MOF; otherwise, MOF would not be interested in a town hall meeting involving all other ministries from both sides that may achieve very little outcome. At a glance, the request by Utsumi for exclusive channeling may seem like an extraordinary step taken by Japan, but behind MOF's action was the intent for power balance, in

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<sup>260</sup> Takita, 2006. pp.32-33.

purpose of elevating the MOF's negotiation and policymaking levels equivalent to those of the U.S. Treasury.<sup>261</sup>

Hence, the bilateral negotiations toward the Plaza Accord would inevitably manifest characteristics of a “behind closed doors” negotiation. It was from this point that the BOJ was left out in the start-up process. On December 17, 1984, the BOJ Governor position changed hands from Haruo Maekawa (前川春雄) – who would in 1986 lead the Maekawa Commission to draft the Maekawa Report – to Satoshi Sumita, a former MOF administrative vice-minister. Sumita would be informed about the Plaza plans only a little more than a week before the Plaza meeting. In addition to Oba, Minister of Finance Noboru Takeshita, PM Yasuhiro Nakasone were the small group of people aware of the Plaza plans.<sup>262</sup> In contrast with the MOF leadership that tends to his political bases and factional party politics in the parliament in addition to ministerial duties, the BOJ leadership is highly centralized at the Governor level and lasts typically for 5 years.<sup>263</sup> The MOF had shaped the policy decision-making structure in such a way that it would have full control in establishing their policy goals and orientations, and to avoid any conflict with or disturbance by other institutions in the bureaucracy. With the U.S. Treasury – MOF at the center of the currency negotiations, the MOF was easily able to

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<sup>261</sup> Takita, *ibid.* pp.30-32. Utsumi's strategy on negotiating with the U.S. Treasury involved his institutional motivations to strengthen the MOF through dialogues on financial liberalization and yen internationalization. He saw that MOF would benefit from negotiating with a high-level ministry in the U.S., and carefully demanded that the bilateral working group to be established on such delicate issues would mainly include MOF bureaucrats in charge of relevant tasks, disallowing ministries other than MOF to participate in the group. At his request, U.S. concerns that a grand ministry like MOF would not even budge disappeared, and Sprinkel agreed to the exclusive bilateral channels for negotiation.

<sup>262</sup> Grimes, 2001. p.113.

<sup>263</sup> Grimes, *ibid.* pp. 97-98.

turn the process toward negotiation as an opportunity to their bureaucratic interests, toward further empowerment and exclusivity as a ministry in the Japanese bureaucracy.

In the beginning, an initial approach from the U.S. side to the Japanese policy makers was via Robert McNamara's bilateral contact with Japanese Vice Minister for Finance Tomomitsu Oba in a phone call, soliciting Oba to join him in a conference for U.S. banking industries held in Hawaii in October 1983. Oba agreed to meet him in Hawaii, but admits to not having anticipated a specific agenda in mind for their proposed meeting.<sup>264</sup> In other words, Japan was aware of the political debate within the U.S. regarding the yen-dollar rate, but was not in expectation of the U.S. political pressures that would be imposed on Japan. At the meeting, McNamara requested for Japan's efforts in internationalizing the Japanese yen, lax regulations, and liberalization of Japanese financial and capital markets.<sup>265</sup>

Oba and McNamara met again in San Francisco, and were joined by four additional Japanese bureaucrats from the MOF (then 大蔵省): Makoto Utsumi, Japanese Finance Minister to the United States (外務省在米国大使館財務公使); Toyoo Gyoten (行天豊雄) Deputy-Director General for Banking Affairs (銀行局審議官); Mitsuo Sato (佐藤光夫), Deputy-Department Head for International Finance (国際金融局次長); Shigemitsu

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<sup>264</sup> Takita, *ibid.* p.21. Oba jokingly recalls that because October 10<sup>th</sup> was Health and Sports Day (体育の日) in Japan, he thought of going to Hawaii just to go for a swim. Instead, he faced McNamara and Paul Volcker, then Chairman of the FRB in serious conversations over a meal regarding serious U.S. requests. He notes that Volcker stayed silent, while McNamara did all the talking.

<sup>265</sup> A controversial figure in U.S. history, Robert S. McNamara served as Secretary of Defense during the Kennedy Administration, but had also been offered the position of Secretary of Treasury, which he declined over the Secretary of Defense position. Following his service as Secretary of Defense, he served as the President of the World Bank.

Sugisaki (杉崎重光), Vice Finance Officer (副財務官).<sup>266</sup> The second time around, Oba sensed that there must have been significant levels of discussions within the U.S. policymakers that took place from the end of September to early October of 1983. These prior meetings and preparations with regard to yen-dollar rate issues were convened in secrecy under the objective of achieving smooth bilateral talks during President Reagan's visit to Japan from November 9 to 12, 1983. During the meeting, the two countries agreed to establish an ad hoc Yen-Dollar Working Group (the Yen-Dollar Committee). From February to May of 1984, the two sides held six secret Committee meetings to discuss the value of the Japanese yen (See **Table 5-1** for dates and venues of the meetings), and came up with a report on the past meetings on May 30, 1984. The contents of the report focused mainly on the issues of opening Japan's financial and capital markets, with aims to persuade the Japanese to seek efforts to internationalize the Japanese yen.<sup>267</sup> However, the U.S. goals to strengthen the yen were met with very little success, and the U.S. embarked on an initiative to impose alternative measures.

*Japan's Acquiescence in the Plaza Accord (1985)*

It was not until James Baker replaced Donald T. Regan as U.S. Secretary of Treasury that U.S. assertions on Japanese yen appreciation was clearly manifested into policy

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<sup>266</sup> Takita, *ibid.* Oba also recalls that during this bilateral meeting when the subject of yen-dollar rate was raised, U.S. Treasury officials asserted that the matter is at their discretion (Oba alludes to the possibility of U.S. Secretary of Treasury, Donald T. Regan being fully assigned for the matter, as President Reagan, with an acting career background prior to presidency would not be knowledgeable in details of finance).

<sup>267</sup> 'Report of the Yen-Dollar Committee' (日米円 \* ドル委員会報告書); 'The Present Status and Outlook on Financial Liberalization and Yen International Liberalization' (金融の自由化および円の国際化についての現状と展望)、大蔵省、May 30, 1984.

pressures.<sup>268</sup> Oba also notes that the Regan-Sprinkel line was more ‘free-market’ oriented, resisting the options of direct intervention in the market. However, under the Baker-Mulford line, the approaches to the issues of currency would change completely.<sup>269</sup> On March 28, 1985, a resolution by the U.S. Senate to request actions on Japan set the stage for further U.S. pressures on Japan. Shortly after in April of 1985, the Committee on Finance of the U.S. Senate released a report recommending the U.S. President to seek action on Japan’s unfair trade practices.<sup>270</sup> Prior to the G10 Finance Ministers meeting in Tokyo on June 21, 1985, Under Secretary for International Affairs for the Department of Treasury David Mulford and Tomomitsu Oba of the MOF held an informal meeting on June 19, at the request by the U.S. At the meeting, Japan offered to consider the option of market intervention.<sup>271</sup> At the G10 meeting in Tokyo, finance ministers saw that a complete return to the fixed exchange rate system would be difficult, and thus agreed on strengthening the surveillance system to stabilize foreign exchange rates.<sup>272</sup> U.S.-Japan bilateral meetings continued in the summer of 1985 toward the Plaza Accord. Minister of Finance Takeshita and U.S. Secretary of Treasury James Baker held a meeting on June 22, 1985, to the intent of both sides to discuss macroeconomic policies

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<sup>268</sup> Noguchi, 2001. p.10. Donald Regan, Secretary of Treasury (1981-85) before James Baker, stepped down and took Baker’s position as Chief of Staff (1985-87). Baker served as Secretary of Treasury from February 3, 1985 and remained in the position throughout the negotiation periods for the Plaza Accord and the Louvre Accord (1985-88). Noguchi notes on the change of hands of the U.S. Secretary of Treasury position as surprising for most policymakers at the time of announcement, at a G5 meeting reception hosted by the FRB 9 months prior to the Plaza Accord.

<sup>269</sup> Takita, *ibid*, p.158.

<sup>270</sup> The 99<sup>th</sup> U.S. Congress, Committee on Finance, U.S. Senate, ‘Requiring the President to Respond to Unfair Trade Practices of Japan’ (submitted by Bob Packwood, Chairman of the Committee on Finance), July 9, 1985. <http://www.finance.senate.gov/library/reports/committee/download/?id=35891368-9edb-44f8-a530-3eb3205068e4>

<sup>271</sup> Takita, *ibid*. p.416.

<sup>272</sup> Policy Bluebook, Ministry of Foreign Affairs, Japan. 1987. <http://www.mofa.go.jp/policy/other/bluebook/1987/1987-4-4.htm>

that may influence the foreign exchange market. The second-tier officials, Mulford and Oba also met in Paris on June 23 and in Hawaii on August 21 that year, and framed the basic idea of the Plaza Accord, based on two pillars: policy coordination and market intervention.<sup>273</sup> Japan received the first draft of the Plaza Agreement statement on September 6. The negotiations were near finalization. On September 15, G5 members met in London to discuss the Plaza Accord statement and the methods of intervention, and on September 22, at the Plaza Hotel in New York, the agreement on the statement was reached, calling for members to directly intervene in the foreign exchange market by buying U.S. dollars and selling currencies – the Japanese yen and Deutschmark. Just before the agreement, the yen's value was 242 yen against the dollar.

### **Post-Plaza Accord and Implications of Japanese Acquiescence**

Following the Plaza Agreement in 1985, the Japanese economy in 1986 showed slow but steady growth in consumption and high rates of investment in the housing sector. Due to the yen's rise, external demand fell to the minus level for the first time in seven years.<sup>274</sup> It was not until May 13, 1986 that the U.S. Treasury officials would say there would be no further need for the yen to appreciate against the dollar – the yen had entered the range of 160 yen against the dollar.<sup>275</sup> Nonetheless, post-Plaza Accord arrangements did not solely involve foreign exchange market intervention, but also further requests by the U.S. to higher the value of the Japanese yen. The U.S. policymakers felt the need for the U.S. dollar to fall further in order to lessen the U.S. trade deficit with its major trading

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<sup>273</sup> Takita, *ibid.* p.414.

<sup>274</sup> White Papers of Japan, 1986-87. pp.85-89. The Japan Institute of International Affairs.

<sup>275</sup> Takita, *ibid.* p. 416.

partners.<sup>276</sup> At the Louvre Accord on February 22, 1987 following the Plaza Accord on September 22, 1985, in order to stabilize international currency value, the 10 countries' finance ministers conference meeting, the IMF Temporary Committee, and the Tokyo Summit agreed to establish multilateral surveillance procedures and Japan would positively engage in this surveillance.<sup>277</sup>

With hindsight, Japan's acquiescence, or compliance to the U.S. request to appreciate the Japanese yen, was a policy answer to the U.S. in its own way. Japan's strategy involved both the initiative to respond to the U.S. as well as to the international community (involving mainly the G5-G10) that it will take the actions required if necessary. In the process of formulating its policy, the negotiators at the Ministry of Finance sought to dominate the access to information in order to increase its leverage within the Japanese bureaucracy. While the Prime Minister was informed about the policy framework before the BOJ was, the Prime Minister was not as equipped with the technical knowledge and means to give directions. After the Tokyo Summit of May 1986, after the yen had appreciated considerably against the dollar, Prime Minister Yasuhiro Nakasone's focus was solely on defending his party interests to win both the Lower House and the Upper House election that would be held in June 1986 - he ordered MOF vice minister for international affairs Toyoo Gyoten that the yen's value be restored to 170 yen against the dollar.<sup>278</sup>

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<sup>276</sup> James Sterngold, 'Dollar Low Against Yen; Gold Hits a 3-Year High', *the New York Times*, September 20, 1986. Secretary of Treasury James Baker was quoted as saying that the dollar needs to fall further if Japan and Germany did not raise their interest rates, and Beryl W. Sprinkel was quoted saying that the dollar will need to fall further in order to reduce U.S. trade deficits.

<sup>277</sup> JIIA White Paper, 1986. The Managing Director of the IMF also participated in the Louvre Accord.

<sup>278</sup> Grimes, 2001. p. 119

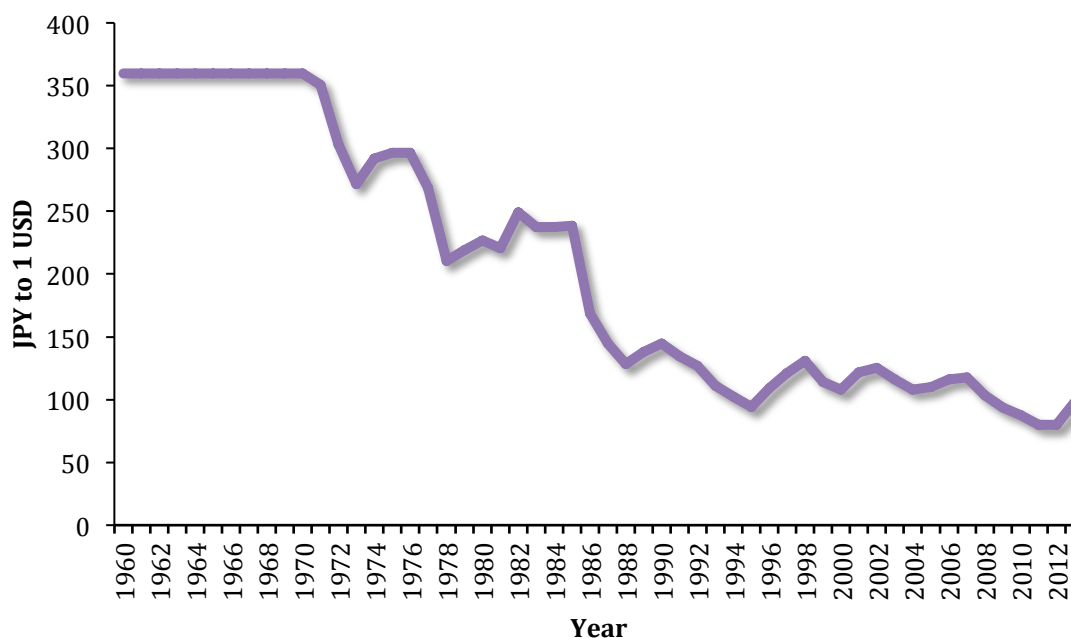
The Diet also was not part of the process – because the Plaza Accord was in the form of a ‘fait accompli’, no voice from the Japanese Diet, nor the public, would be reflected or taken into consideration toward policy formulation. Governor Sumita of the Bank of Japan, participated in the actual signing of the Plaza Accord, the BOJ did not exert much influence in the course of policymaking. Rather, its role was one of policy implementation post-Plaza Accord, with regard to market intervention and interest rate arrangements.

Overall, the asymmetric access to information toward the Plaza Accord resulted in MOF’s policy dominance. In essence, Japan’s acquiescence to U.S. currency appreciation pressures was born out of economic reasons – how best to deal with or deflect the protectionist response in the US to expanded Japanese exports; and the MOF was to gain in institutional advantage. On the MOF’s institutional advantage, previous study has argued that the MOF was willing to accept yen appreciation as long as its primary objective for budget consolidation would not be compromised.<sup>279</sup> The fact that the MOF was seeking to maintain its control of fiscal policy is very true for a ministry that has reigned over the Japanese bureaucracy by allocating budgets for ministries since the postwar period, but my point of argument here is that in addition to the domestic initiatives in fiscal policy, the MOF sought to reinforce its bureaucratic dominance by gaining negotiating leverage with a foreign entity on monetary affairs as well.

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<sup>279</sup> Grimes, 2001. p.226. Grimes emphasizes the organizational supremacy of the MOF’s Budget Bureau as the source of the organization’s pursuit of fiscal stability and control over fiscal policy.

Figure 5-1. JPY-USD Exchange Rates (1960-2013)



Source: By author based on exchange rate data from the Federal Reserve Board foreign exchange rates

Table 5-2. JPY Appreciation against the USD (1949-1995)

Date	JPY-USD Rate	Notes
April 25, 1949	360.00	Fixed Exchange Rate
December 18, 1971	308.00	Nixon Shock (August 15, 1971)
February 12, 1973		Smithsonian Agreement; Floating Exchange Rate
October 31, 1978	175.50	Peak since 1949
October 29, 1982	278.50	Peak since adopting the floating exchange rate system
September 22, 1985	240.00	G5, Plaza Accord, New York
February 22, 1987	150.00	G7, Louvre Accord, Paris
September 24, 1992	119.83	Breaks 120.00 line for the first time
April 21, 1993	109.90	Breaks 110.00 line for the first time
June 27, 1994	99.50	Breaks 100.00 line for the first time
March 8, 1995	88.75	Breaks 90.00 line for the first time
April 19, 1995	79.75	Breaks 80.00 line for the first time

Source: By author based on Ishikawa, 1985, p.173.

### South Korea – Strong Presidency and the MOF’s Lack of Stratification

Similar to the Japanese case, the channel between the U.S. and South Korea regarding currency matters was centered at the levels of financial ministries – the U.S. Treasury and the South Korean Ministry of Finance. South Korea’s Ministry of Finance is a powerful

ministry that has continuously battled with the Bank of Korea throughout the political transitions in the postwar era (See **Figure 2-5** in Chapter 2). For South Korea, U.S. pressures were existent from the late 1980s, but South Korean policy actions to deflect the pressures resulted in steady appreciation and half-hearted market opening. The currency appreciation pressures from the U.S. came in the late 1980s, as South Korea's trade balance surplus with the U.S. was on the rise. Initially, the South Korean bureaucrats sought to resist the pressures. As South Korea's worldwide exports took off, the chaebols heavily benefited from the government export strategies, and borrowed continuously to expand their revenues. In the absence of a sound supervision of the chaebols, corruption, cronyism, and market distortion by the chaebols became commonplace. To a certain extent, this is still the case for South Korea today. The big capitulation to U.S. pressures would come indirectly via the form of IMF pressures in the Asian Financial Crisis of 1997, in which the South Korean economy was crippled and the South Korean government adopted the demands of the U.S. and IMF wholesale. While the external pressures to restructure the corporate world in South Korea was included in the demands by the IMF, studies have noted that IMF guidelines were in many ways inappropriate in managing the Asian Financial Crisis, and that South Korea recovered fast by not following all of the standard IMF guidelines.<sup>280</sup>

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<sup>280</sup> Stiglitz, 2002. p. 117. Stiglitz has argued that the IMF lacked understanding of financial markets and that the IMF guidelines on Indonesia were disastrous. He notes that in the South Korean case, the government took an active role rather than just listening to outside advice from the IMF. For example, it did not follow the IMF advice and recapitalized its two largest banks instead of closing them down. In corporate restructuring, the government took on a fast-paced method of financial restructuring of firms in distress within two years.

South Korea's bilateral trade surplus with the U.S. had begun in 1986. When it surpassed that of Taiwan's in 1988, it began to cause deep domestic concerns in the United States. Among the Asian NICs (newly industrialized countries), South Korea alongside Hong Kong and Taiwan had run trade surpluses with the U.S. in the 1980s. The Asian NICs maintained low-valued currencies relative both to the U.S. dollar and the Japanese yen, were export-driven with high saving rates and protected domestic markets, except for Hong Kong. Since 1986, the U.S. government trade policy on Taiwan and South Korea emphasized currency appreciation and import liberalization. The U.S. dollar had been depreciating against the currencies of Taiwan and South Korea, and the depreciation of the dollar was generating concerns in Washington.<sup>281</sup> However, the U.S. political pressures for Asian NICs currency appreciation were manifested with lesser teeth, as the U.S. Congress and U.S. Treasury officials did not stand side by side on the degree of pressure to be deployed to tackle the issues of bilateral trade deficits with Taiwan and South Korea.<sup>282</sup>

The fact that the two countries were making some progress in response to the U.S. requests toward market opening, albeit in incremental terms, also made simply arguing

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<sup>281</sup> Baker, 1995. p. 44. In his autobiography, Baker states that at the U.S. Treasury, trade and currency discussions with Taiwan, Singapore, and Hong Kong. In actuality, Singapore and Hong Kong got off the hook with only a warning. Baker, Robert Zoellick, Bob Fauver came up with the development of the idea of a pacific organization. This became the startup for the APEC.

<sup>282</sup> In a congressional hearing, Secretary James Baker is pushed to the edge by Chairman Lloyd Bentsen of Texas, Chairman of the Senate Committee on Finance with regard to the actual methods of imposing pressures on the Asian NICs for currency appreciation. Baker suggests engaging in a bilateral negotiation with each country, noting that the Taiwan dollar has shown some movement. The Chairman refutes by saying that on the South Korean won, not much has changed. Baker refutes by saying South Korea is not a major problem as it is the first time scoring trade surplus with the U.S., and that it is on the front lines in terms of U.S. national security interests, and therefore dismisses the idea of mandating legislative solutions to the question of exchange rates. Bentsen takes Baker's response as diplomatic and asks Baker to push further on the two countries. 'Mastering the World Economy: Hearings before the Committee on Finance', United States Senate, 100<sup>th</sup> Congress, Pt.4, p.36, 1987 (Also quoted by Lindner, 1992. p.24).

for imposing public pressures fairly difficult. More importantly, there were threats of potential harm that may undermine the budding diplomatic relationship that the U.S. had built over the years with the two countries on the security and military front.<sup>283</sup> The variance in the degree of pressures was also attributable to the small sizes of the economies that the Asian NICs had.<sup>284</sup> This was all the more the case for the South Korean economy, as South Korea was still viewed by the U.S. as a debtor nation that had just graduated from the calamities of the Korean War. Seen from a relative perspective, all of the factors involved – incremental progress by the two countries, security ties and partnerships, scale of economy and impact – contributed to creating an atmosphere for divided opinions in Washington on whether to impose strong pressures on the two countries. The divided policy sphere resulted in a relatively lower degree of pressures as a policy outcome, and ultimately, much less debated and put into policy action in the U.S. Congress than as was in the cases of Japan in the 1980s and China in the 2000s.<sup>285</sup> To

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<sup>283</sup> Henning, 2008. p. 24. Henning notes that C. Fred Bergsten and then Assistant Secretary of Treasury for International Affairs David C. Mulford had advocated appreciation of Taiwan and South Korea's currencies in 1986 and 1987, supported by analysis by Bela Balassa and John Williamson (1987, 1990). Ironically, in May 1987 Bergsten is quoted as saying that the focus of exchange rate realignment should be on Japan and Europe, not on developing countries, including Korea. (See Lindner, 1992. p. 13)

<sup>284</sup> U.S. General Accounting Office Report No. 138600, 'U.S. Trade Deficit: Impact of Currency Appreciations in Taiwan, South Korea, and Hong Kong', Statement of Allan I. Mendowitz, Director of Trade, Energy, and Financial Issues, National Security and International Affairs Division, Before the Subcommittee on International Trade, Committee on Finance, United States Senate. May 12, 1989. The statement reveals the simulated results on a possible appreciation of Asian NICs currencies by a Data Resources, Inc., a consulting agency established in 1986 that provides data analysis services that GAO contracted with for analysis on Asian NIC currencies. The results showed that Taiwan and South Korea have acted to prevent their currencies' values from reflecting their economic strengths, and that although both countries allowed significant appreciation of their currencies against the dollar, the efforts did not satisfy U.S. objectives. The results also showed that appreciation of the Asian NICs' currencies may modestly reduce U.S. trade deficits with them, but with minor impacts on the overall U.S. trade deficit, and concluded that exchange rate adjustments alone will not resolve the mounting U.S.-NIC trade imbalances.

<sup>285</sup> 'A "Super 301" Trade Ruling: Too Early for Seoul and Taipei', *Backgrounder*, No.91, Asian Studies Center, The Heritage Foundation, May 25, 1989. While the policy brief refrains from reflecting the views of the Heritage Foundation, a fairly conservative think-tank in D.C., as an attempt to aid or hinder passage

that extent, the U.S.-Korea currency conflict was never really under the spotlight in the two countries' policy spheres, before and after the appreciation. The 'behind-the-scenes' stories were told only via memoirs, internal official records, rarely via public documents or newspapers in the early 1990s, and thus were not heavily publicized.

South Korea had implemented the manage float exchange rate system in March 1980, and by the end of the 1985, the year that the Plaza Accord was signed, the won had depreciated 35 percent in nominal terms against the dollar. The appreciation of G10 currencies against the dollar in 1986-1987 was not matched by the appreciation of the won, as the won rose about 12 percent against the dollar during those two years. The won depreciated against the Japanese yen over 60 percent by end of 1987. Partly owing to the results of these exchange rate changes, South Korea's current account had turned from deficit to surplus in the 1980s.<sup>286</sup>

*South Korea's Currency Negotiation with the United States (1987-88)*

It was at this time that the South Korean government would face severe U.S. currency appreciation pressures. The U.S. Treasury approached the South Korean Ministry of Finance (now the MOSF) during the transitional phase from the Chun Doo-whan and Roh Tae-woo Administrations in 1986-1987. Within the two-year span from April 1987 to August 1989, the U.S. Treasury persistently requested appreciation of the South Korean won, and the KRW rose from 881 won to the dollar in 1986 to 671 won in 1989.

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of relevant bills before Congress, it explicitly states that in the interests of the peculiar bilateral relationships the U.S. has with the countries and generating anti-Americanism, it should avoid further conflict by solving the issues of bilateral trade imbalances at the international level via soliciting them to international economic organizations (i.e., OECD, GATT) rather than relying on the Super 301 for the U.S. to gain further market access to Taiwan and South Korea.

<sup>286</sup> Lindner, 1992. p.8

South Korea's capital account that had scored a surplus in 1986 for the first time turned into a deficit in 1990.<sup>287</sup> Policymakers of the time recount that this happened mainly because South Korea's current account surplus from the years 1986-1988 was generated from the external factors of exchange rate changes in the Plaza Accord. In other words, South Korea benefitted mainly from price competitiveness via external factors, without essential improvements being made on economic fundamentals. Such improvements were largely owing to the rapid rise of wages amid labor movements following South Korea's democratization. Naturally, when the Japanese yen value rebounded in early 1990, the South Korean won's competitiveness disappeared, and South Korea's current account turned into a deficit.<sup>288</sup> Additionally, another critical factor that led to the deficit was soaring oil prices in the first Gulf War of 1990.

In the morning of August 4, 1986, Richard L. Walker, then U.S. Ambassador to South Korea, was summoned to the Ministry of Finance by finance minister Chung In-yong (鄭寅用), in response to U.S. Secretary of Treasury James Baker's request via the ambassador to seek consultation with the South Korean officials on the matter of the South Korean won's exchange rate. At the time, it was a rare case that a U.S. Treasury Secretary would call on an U.S. Ambassador, instead of Secretary of State. Should the

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<sup>287</sup> *Hangugyeongje byeog-eul neom-eoseo: 2014 gyeongje hoebog-ui bunsulyeong* (한국경제 벽을 넘어서: 2014 경제 회복의 분수령), NEAR (North East Asia Research) Foundation, 2014. Established in 2007, the NEAR Foundation is a conservative think-tank led by Chung Duk-koo, who served as Deputy Finance Minister under the Kim Young-sam administration. The report warns against any potential currency conflict with the U.S. post-Global Financial Crisis, based on the lessons South Korea learned in the currency appreciation negotiations in the late 1980s.

<sup>288</sup> Roh, 2011. In his memoir, former president Roh Tae-woo stresses the external variables that led to the current account changes, and rejects claims that his administration ruined the economy after what his predecessor, Chun Doo-whan's administration had achieved. His main argument is that due to the appreciation pressures, the exchange rates were not up to par to match the rising wages, household spending, and government expenditures.

issue of official levels became an issue in channeling, the South Korean Finance Minister was to also communicate via the U.S. Ambassador to South Korea as a protocol and agreement with the U.S.<sup>289</sup> The following day, a newspaper reported that Chung explained to Walker about the South Korean floating exchange rate system in detail and that since the won-dollar exchange rate was evaluated to be at an appropriate level, there was no South Korean intent for artificial appreciation of the currency and that retaining the existent floating exchange rate system would be enough to reflect on the actual prices. It was also reported that South Korea regretted the inappropriate action by the U.S. to allow press releases prior to the two-sides' reaching of an agreement.<sup>290</sup> In the beginning, South Korea would not budge.

From April 27 to 29 in 1987, the Asian Development Bank Annual Meeting was held in Osaka, Japan. At the event, U.S. Treasury officials David Mulford and Charles Dallara approached South Korean delegates via requesting an informal hotel room visit in addition to soliciting finance minister Chung In-yong to personally meet Treasury Secretary James Baker.<sup>291</sup> Upon meeting bilaterally in August 1987, Baker requested the appreciation of the South Korean won, asserting that the won (6.45% appreciation) had not appreciated as much as the Taiwanese dollar (15.3% appreciation) or the Japanese

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<sup>289</sup> Chung, 2002. pp.164-165.

<sup>290</sup> Chung mentions that Walker recounted the event in his memoir.

<sup>291</sup> Chung, *ibid.* p.163 notes that he responded that he would try to meet Baker during the upcoming IMF Temporary Committee meeting in August that year to avoid appearing as if he as a minister of finance of a country were being bossed around (by the U.S.). Attending the meeting was an excuse to meet Baker. As the architect of the South Korean currency reform under Park Chunghee, Chung was the most appropriate and fit delegate from South Korea for negotiation. Without a memo, Chung held hours of lengthy discussions with Baker and his aides. Baker was quite adamant about his position on won-dollar exchange rates, saying that he would consider incorporating all measures possible (alluding to the application of Super 301) until he felt it was 'satisfactory enough' to address the concerns of the U.S. Congress.

yen (10.3% appreciation) during January to September in 1986 (for exchange rate movements, see **Table 5-2**).<sup>292</sup> At the time, both countries had upcoming elections scheduled, and incumbent political parties on both sides felt pressured by domestic political motives. U.S. Treasury officials demanded that the won rise to the 600 level. South Korea reluctantly agreed to raise the exchange rates to the 800 level before the South Korean presidential election scheduled for December 16, 1987 – still, South Korea argued, the action would suggest a modest rate of 7% appreciation of the won.<sup>293</sup> The South Korean defense was that while Taiwan held almost no external debt and had maintained current account surpluses throughout the 1980s, South Korea scored a current account surplus for the first time in 1986, and that it held large sums of external debt, with wages and prices rapidly rising. Chung delivered the South Korean position to Baker that a drastic lowering of the exchange rate would be difficult, and that South Korea would gradually appreciate the Korean won under the floating exchange rate as it had done since 1980.<sup>294</sup> At the end of the talks, Baker said exchange rate issues were ‘a pain in the neck’, and suggested resolving it at the international level via the IMF. Chung agreed enthusiastically, thinking that South Korea would be able to avoid direct confrontations with the U.S. if the matter were to be handed over to the IMF, an

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<sup>292</sup> Korea Development Institute, ‘South Korea’s Improvement of Financial and Exchange Rate policies in the process of financial globalization’ (*Geum-yung-gugjehwagwajeong-eseoui hangug-ui geum-yung-oehwanjeongchaeg-ui gaeseon*), Vol.014, January 1991.

<sup>293</sup> Chung, *ibid.* p.63. Baker is described as fairly goal-minded when he asked back, “What about after the election?” meaning “what will happen to the negotiation and currency appreciation (and government leadership)” after the government change. Chung retorted by saying, “I will be leaving, and that will be a new game set up according to the election results.” Chung was offered a high-level government position as vice prime minister under Roh Taewoo from May 1987 to February 1988.

<sup>294</sup> ‘Finance Minister Chung In-yong announces intent for gradual won appreciation’ (*Jeong-in-yong jaemubujang-gwan, wonhwajeolsang jeomjinjeog silsi eonmyeon*), archive records, National Museum of Korean Contemporary Archives, 1987.

international organization with some impartiality and credibility. The results of the talks were conveyed directly to former vice prime minister Kim Man-je upon Chung's return to South Korea, that currency issues and maintenance of the won-dollar exchange rate at the appropriate level would be handled in consultation with the IMF.<sup>295</sup> However, this policy choice resulted in South Korea's postponing the homework in response to U.S. currency appreciation pressures, or further market opening pressures at a later period.

Consequently, in 1987, South Korea appreciated the won 6.7% (year on average) against the dollar: in 1988, 11.1%, and in 1989, 8.1%. From September 1985 to June 1989, the won appreciation rate in nominal terms was clearly lower than those of Japanese yen and Taiwanese dollar, but in real terms, matched that of the Taiwanese dollar (see **Table 5-3**). From February 1980 to March 1990, South Korea operated on a crawling peg, multicurrency basket system for calculation of its exchange rate. The multicurrency basket system would, enable the Bank of Korea to calculate the range of the crawling peg based on a certain weight decided by the fluctuations of major currencies in the world, with reflections of South Korea's current account balance, and the differentials of South Korea's interest rates and inflation rates with other countries. The Bank of Korea would officially announce the rate each day. Regardless of the

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<sup>295</sup> Chung's anecdote reveals how he sought to deflect direct U.S. pressures. After the consultations, Baker asked Chung to join him for a round of golf in Hawaii with the Taiwanese finance minister. Baker sought to send Mulford over to Taiwan for consultations on currency appreciation, but the problem was that due to the U.S.-China joint agreement in the Shanghai Communiqué in 1972, high-ranked U.S. officials would not be able to visit Taiwan. Chung quickly declined the offer to join them, fearing that South Korea's interests could be damaged if the Taiwanese and Korean situations became enmeshed in a three-party talks on currency appreciation. Regardless, the task was handed over to Lee Yong-sung, Deputy Secretary General for Planning and Management of the Ministry of Finance, who attended a bilateral meeting with the U.S. on international finance right after Roh's inauguration, and in March 1990, South Korea adopted the market average exchange rate system.

exchange rate changes, the U.S. Treasury listed South Korea as a currency manipulator in its October 1989 report. South Korea feared the possibilities of U.S. retaliation via implementation of ‘Super 301’. The background of South Korea’s qualms was as follows. Pursuant to the Exchange Rates and International Economic Policy Coordination Act under the Omnibus Foreign Trade and Competitiveness Act that was signed by President Ronald Reagan in 1988, the U.S. Treasury was required to submit to the Committee on Banking, Finance, and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate before October 15 of each year, an annual (semiannual from 2001) written report on international economic policy, including exchange rate policy.<sup>296</sup> The South Korean won and the Taiwanese dollar were mentioned in the Treasury reports from 1988, mainly because they had external surpluses and a managed float system with restrictive capital controls.<sup>297</sup> Japan and Germany at the time also had external surpluses, but maintained floating exchange rates, and thus were not mentioned in the report. States that were designated as ‘currency manipulating countries’ in the reports would be subject to U.S. political pressures to realign their currency values. The Omnibus Foreign Trade and Competitiveness Act contained another

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<sup>296</sup> Section 3004 of the bill requires the Treasury to “consider whether countries manipulate the rate of exchange between their currency and the U.S. dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.” The bill was submitted by Senators Max S. Baucus of Montana, Daniel P. Moynihan of New York, and Mark Sanford of South Carolina. In particular, Moynihan’s submission of the bill entitled ‘Exchange Rate Adjustment Act of 1987’ mandates the U.S. Treasury to start a currency negotiation (<http://www.gpo.gov/fdsys/pkg/HOB-1987/html/HOB-1987.htm>). Senators Lloyd Bentsen and Dan Rostenkowski also submitted a revised trade bill in 1988 for similar purposes. (See article: <http://www.nytimes.com/1988/06/24/business/70-senators-sponsor-new-trade-bill.html>)

<sup>297</sup> Subtitle A. Exchange Rates and International Economic Policy Coordination Act, Title III. International Financial Policy, Omnibus Foreign Trade and Competitiveness Act 1988 of the United States (Pub.L. 100-418). For full text, see United States Code, Office of the Law Revision Counsel (<http://law2.house.gov/view.xhtml?path=/prelim@title22/chapter62/subchapter1&edition=prelim>).

section, the ‘Section 301’, which was used as a powerful tool for the U.S. in pressing trade partners for market access.<sup>298</sup> Both the Exchange Rates and International Economic Policy Coordination Act and the Section 301 were used by the U.S. as a comprehensive and strategic tools to bring about Asian NICs’ cooperation as a response to U.S. political pressures.

**Table 5-3. Monthly Exchange Rates – October 1986 (Currency Units per USD)**

	<b>Oct. 1986</b>	<b>Feb. 1985</b>	<b>July 1980</b>	<b>% Change Since Feb. 1985</b>	<b>% Change Since July 1980</b>
<b>German Mark</b>	2.01	3.30	1.75	-39	+15
<b>Canadian Dollar</b>	1.39	1.35	1.15	+3	+21
<b>Japanese Yen</b>	156	261	221	-40	-29
<b>Italian Lire</b>	1,388	2,041	832	-32	+67
<b>Taiwanese Dollar</b>	36.65	39.23	---	-7	---
<b>Korean Won</b>	879	839	607	+5	+45

*Source: Mastering the World Economy, Pt.2, p.44*

**Table 5-4. U.S. Requests for KRW Appreciation, 1987-1989**

<b>Negotiation Date</b>	<b>U.S. Requests: Appreciation Rate (End of Month, W/\$, %)</b>	<b>Actual Appreciation Rate (End of Month, W/\$, %)</b>
<b>April 1987, September 1987</b> Bilateral meetings during the ADB Annual Meeting & IMF Temporary Committee Period	<b>March-June 1987</b> 846.9 → 780 (7.9%)	<b>June 1987</b> 808.9 (4.5%)
<b>April 1988</b> Baker-Dallara	<b>March-June 1988</b> 746.2 → 700 (6.2%)	<b>June 1988</b> 728.3 (2.4%)
<b>December 1988</b> Deputy Finance Ministers Meeting	Continued appreciation	
<b>February 1989</b> Finance Ministers Meeting	Continued appreciation up to appropriate level	
<b>March 1989</b> Deputy Finance Ministers Meeting	<b>March-May 1989</b> 671.9 → 650 (3.3%)	<b>May 1989</b> 666.7 (0.8%)
<b>April 1989</b> Deputy Finance Ministers Meeting	671.9 → 657 (2.2%)	<b>June 1989</b> 667.2 (0.7%)
<b>August 1989</b> Secretary Brady’s Letter	a) Continued appreciation b) Regular meetings on Financial,	

<sup>298</sup> For full text of the Section 301, see U.S. Code Title 19, Chapter 12. Trade Act of 1974, Subchapter III. Enforcement of United States Rights Under Trade Agreements and Response to Certain Foreign Trade Practices, sections 2144-2420. For full text, see United States Code, Office of the Law Revision Counsel (<http://uscode.house.gov/browse/prelim@title19/chapter12/subchapter3&edition=prelim>).

	Foreign Exchange, and Capital Markets	
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*Source: Ministry of Finance, Republic of Korea.*

**Table 5-5. KRW Appreciation against the USD (1986-1991) (Unit: KRW/USD, %)**

	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
1986	885.2 (0.56)	886.6 (0.4)	877.0 (1.48)	861.4 (3.24)
1987	846.9 (1.68)	808.9 (6.09)	805.8 (6.45)	792.3 (8.02)
1988	746.2 (5.82)	728.3 (8.08)	719.0 (9.25)	684.1 (13.66)
1989	671.9 (1.78)	667.2 (2.47)	670.0 (2.06)	679.6 (0.66)
1990	702.1 (-3.31)	716.0 (-5.36)	712.9 (-4.90)	716.4 (-5.41)
1991	724.7 (-1.16)	723.1 (-0.95)	741.5 (-3.50)	NA

*Source: Ministry of Finance, Republic of Korea.*

*Note: Numbers are exchange rates at the end of each quarter. Numbers within parentheses are changes in percentages from end of previous year. Minuses indicate depreciation.*

**Table 5-6. Asian Currency Appreciation against the USD after the Plaza Accord**

Appreciation Rate	Korean won	Japanese yen	Taiwanese Dollar
Nominal	32.4%	72.8%	53.3%
Real	18.6%	21.2%	18.4%

*Source: Korea International Trade Association, 'South Korean Exchange Rate Policy'. September 1989.*

Toward 1988, under continued U.S. pressures, South Korea was going through a political leadership change from former presidents Chun Doo-whan to Roh Tae-woo. While both shared the same profiles as military cadres under Park Chung-hee, they held differing political interests, as Chun was reluctantly stepping down from presidency after a series of political demonstrations, and Roh was the next one down the line to be president. The Chun and Roh political camps were engaged in a war of nerves over who should have the upper hand in candidate nomination for the upcoming general election in April 1988. Coincidentally, the U.S. also had an upcoming presidential election scheduled for November 1988. Naturally, against the backdrop of South Korea's trade surpluses in 1987, the incumbent Republican Party of the United States, would pressure South Korea with the objectives of market access and currency appreciation – all with the

intent of remaining in power with the political agenda of George Bush becoming the next president.

The U.S. pressures on currency appreciation were coupled with the pressures on trade liberalization. The South Korean response to the U.S. pressures was a manifestation of its strong presidency that drives the bureaucracy – the omnipotent presidency that exerts excessive policy influence at the expense of a good policy outcome. The ramifications of the democratization movement in South Korea made the presidency all the more sensitive about public opinion. It was understood that 1987 presidential election would be held under a direct voting system. The South Korean presidency that was very weary of the public opinion played a huge role in fragmenting the policy approaches toward U.S. pressures in the late 1980s. Public opinion in South Korea responded frantically to market opening, especially in the agriculture sector, and the outcome of a presidential election could be heavily influenced by the policy decision on agricultural market opening. The major issues at stake were on opening South Korean markets for U.S. beef, tobacco, and insurance.

In May 1986, then USTR Clayton K. Yeutter flew to Korea demanding beef market opening based on Super 301. In response, then vice prime minister Kim Man-je (金滿堤) under the Chun Doowhan administration had visited Washington on February 26, 1987 and met with Yeutter and Baker individually for discussions on the issues of won appreciation, market access, and beef import.<sup>299</sup> At the meeting, Baker explained to Kim

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<sup>299</sup> ‘U.S. Treasury Secretary James Baker requests South Korea for won appreciation’, Digital Archives, National Museum of Korean Contemporary History, February 26, 1987

about why the G7 Finance Ministers Joint Statement included a statement calling for NICs to appreciate their currencies, and requested for a considerable appreciation of the South Korean won against the U.S. dollar. Later, Kim signed a pact with the U.S. on opening the South Korean beef market, based on the expected timeline that the presidential election and the general election in South Korea would be held at the end of 1987. Before the election, Chun called on Chung In-yong (who had met Baker as Minister of Finance to announce South Korean intent for gradual won appreciation), who succeeded Kim Man-je as vice prime minister, to pay the U.S. a visit to keep his word as his legacy.<sup>300</sup> Chung was also approached by the Republican camp of the U.S. Having close ties with the U.S. presidential candidate George Bush, James R. Lilley, then U.S. Ambassador to South Korea (who succeeded Richard L. Walker), pressured Chung to meet Bush on his visit to the U.S. to show that the two countries are settled on the beef issue. However, Roh was against opening the Korean beef market to the U.S. in fear of losing votes from the agricultural sector in the election.<sup>301</sup> The public opinion in South Korea did not allow for further market opening.

Chung sought advice from his old friend and then Minister of Foreign Affairs, Kwang-su Choi (崔尙洙) on the matter. Choi advised Chung that opening the South Korean beef market is only a matter of time, and that Chung should write the U.S. a memorandum that South Korea will allow beef market opening after the general election.

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([http://www.much.go.kr/story/story.do?\\_method=detailUserStory&page=1&mts\\_idx=10719&mts\\_day=0226](http://www.much.go.kr/story/story.do?_method=detailUserStory&page=1&mts_idx=10719&mts_day=0226))

<sup>300</sup> It is a continued custom in South Korea that the minister of finance would be promoted to the level of vice prime minister.

<sup>301</sup> Chung, *ibid.* pp.184-185.

Chung's scheduled exit as a government official to step down soon made the case of Chung finalizing the issue all the more appropriate – keeping the previous administration's word. On January 4, Chung met USTR Yeutter to say that if the U.S. requires, South Korea is willing to write a memorandum, on the condition that opening the beef market can be delayed until the general election, and on the basis that the content of the memorandum would remain confidential until then. However, Yeutter admitted in all honesty that under the U.S. domestic circumstances, he does not have means to keep it confidential, so an agreement to delay beef market opening in South Korea was reached without writing a memo. In the absence of a memo, it would become increasingly difficult for the Chun administration to avoid national criticism. Chung's defense for not writing a memorandum to the U.S. to his MOFA colleague Choi was that 'should the secret pact be broken, things can get more problematic.'<sup>302</sup>

Meanwhile, on the same trip to the U.S., Chung was approached once again by Secretary of Treasury Baker, seeking further consultations on the South Korean won. At the time, he was reported to have been unsuccessful in securing a meeting with Baker, but Chung notes that he had avoided Baker during his trip to the U.S. to prevent further pressures on the South Korean won. Such individual actions by Chung reveal that the MOF's stratification and pathways toward establishing a clear policy response to U.S. currency appreciation pressures were fairly weak and far from thorough. As a clear policy response was not delivered from the South Korean MOF to the U.S. Treasury, throughout

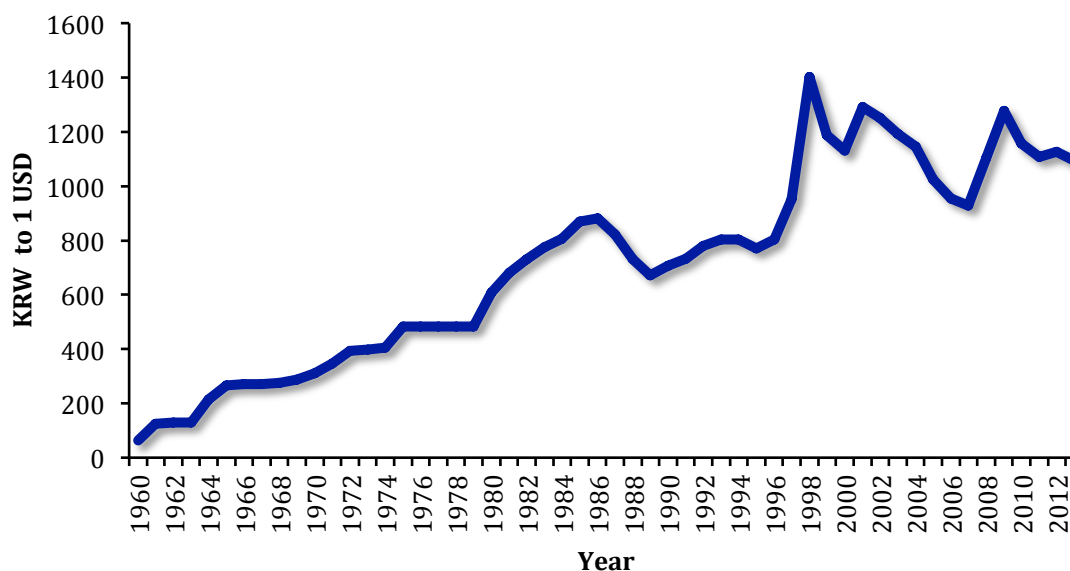
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<sup>302</sup> Chung, *ibid.* pp.186-187. The case on beef was later expanded in the USTR's filing a dispute to the GATT on South Korean beef. The incident also caused uproars in the South Korean domestic political scene, in which Chung was put to testify at the National Assembly hearings regarding the secret pact from opposition party assemblymen during the transition period from the Chun Doo-whan administration to the Roh Tae-woo administration.

the year of 1988, even after the elections and the set of the 6<sup>th</sup> Republic under Roh, the U.S. Treasury continuously demanded further lowering of the exchange rate.

While the most severe U.S. Treasury pressures on South Korea's exchange rate policy has ended, South Korea still remains under the radar of the U.S. Treasury for currency manipulation.<sup>303</sup> South Korea has been listed as a currency manipulating country multiple times in the U.S. Treasury report. At the time of currency appreciation pressures from the U.S., a clear strategy in the South Korean response was missing, and the MOF's solution to the pressures was a continuous ministerial referencing that the policies chosen are based on market fluctuations. South Korean finance ministry officials deny that there are artificial changes made to the exchange rate in response to U.S. pressures.<sup>304</sup>

**Figure 5-2. KRW-USD Exchange Rates (1960-2013)**



*Source: By author based on exchange rate data from the Federal Reserve Board foreign exchange rates*

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<sup>304</sup> Personal interviews. According to MOSF officials, South Korea's exchange rates at the time of U.S. currency appreciation pressures were only a reflection of market dynamics, and while adjustments may be made for stability of the won, exchange rates were not a result of voluntary or deliberate arrangements by the South Korean government.

## China

U.S. currency issues with China and Sino-U.S. negotiations on renminbi appreciation are ongoing as of this writing. U.S. interests on China had been largely military in the postwar years, but since China took on economic reforms from the late 1970s, U.S. economic interests on China started to grow.<sup>305</sup> Currency issues regarding China had been mentioned in the Treasury reports in the early 1990s, but the tensions on the subject did not surface so much as a significant political agenda until the 2000s. By end of 2001 when China entered the world economy via accession to the World Trade Organization, its presence in the global economy had become highly visible. As China's current account surplus began to increase exponentially, and with U.S. domestic markets increasingly dominated by Chinese manufactured goods, U.S. domestic concerns and political debates on the China threat became quite serious. At the same time, due to the interconnectedness of the two economies, the U.S. felt a strong urge to begin a series of talks. At the time, there had been previous setups that the U.S. and China held together, i.e., the Joint Commission on Commerce and Trade (JCCT) established in 1983 and operated by the U.S. Department of Commerce and relevant Chinese ministries in the field of commerce, and the Joint Economic Committee between the U.S. Treasury and the Chinese Ministry of Finance; but full-fledged, strategic and economic dialogues had yet to begin. Meanwhile, the U.S. political sphere already had the U.S.-China Economic and Security Review Commission set up and running through a congressional mandate from October 2000, to monitor and investigate national security and trade issues between the

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<sup>305</sup> Lardy, 1987. As Lardy put it, China's importance had been defined primarily as military rather than economic until the late 1980s.

two countries. Simply put, since China's economic growth took off, the U.S. was already prepared, motivated, and geared toward gaining control of the bilateral relationship.

In the year of 2006, the Bush Administration in agreement with the CCP Leadership under former President Hu Jintao launched the first U.S.-China Strategic and Economic Dialogue (this point forward, S&ED), which have been semi-annually held every year.<sup>306</sup> While the Strategic Dialogue mainly dealt with security issues, led by heads of defense ministries and senior officials, the economic dialogues were predominantly led by the U.S. Treasury and Chinese ministries associated with the economic and financial functionalities and tasks in the Chinese government. In the initial launching statement of the U.S.-China S&ED, it is made explicit that issues in the bilateral dialogues will receive full attention, including pressing China for floating exchange rates among several other relevant policy issues.<sup>307</sup> In the initial phase, Henry Paulson, then Treasury Secretary, would lead the economic track, and Madame Wu Yi (吴仪), then Vice Premier.<sup>308</sup> At the time of Wu Yi's appointment to lead the Chinese delegation, questions on China's intent in the talks arose, as Madame Wu held the vice premiership, which was a higher position than that of the finance minister, and was not exactly Henry Paulson's counterpart in

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<sup>306</sup> The Strategic Track of the dialogue was led by Condoleezza Rice, former Secretary of State under the Bush Administration. Paulson and Rice had built acquaintance prior to joining the administration through former Secretary of State and Treasury George Schulz. See Paulson, 2010, p.53.

<sup>307</sup> U.S. Department of the Treasury Press Center, 'Fact Sheet Creation of the U.S.-China Strategic Economic Dialogue', HP-107, September 20, 2006. On currency issues, the existing economic dialogues included the Joint Commission on Commerce and Trade (JCCT) between the U.S. Department of Commerce, the USTR, and the Chinese Vice Premier responsible for Trade, and the Joint Economic Committee between the U.S. Department of the Treasury and the Chinese Ministry of Finance.

<sup>308</sup> The vice premier position in China are held by multiple people at once (up to four vice premiers at one period), but the order and degree of power varies by individuals.

terms of government hierarchy.<sup>309</sup> In terms of the hierarchy of economic policymaking in China, the Leading Group for Financial and Economic Affairs, led by former President Hu Jintao, would include vice premiers like Madame Wu in charge of financial and economic issues. Paulson's equivalent would be finance minister of China, but China had chosen Madame Wu to lead the negotiations with the U.S. The U.S. saw this not as a problem but an open attitude from the Chinese to take the dialogues very seriously, and Paulson highly appreciated Wu's pragmatism and aggressiveness to go push the process forward.

Under Paulson's leadership, issues on currency in the economic dialogues were not as highlighted in the initial phase of the dialogues, although the U.S. media at the time of S&ED launch was keenly interested in how the U.S. would resolve the issues of trade deficits with China using the tools of currency appreciation pressures.<sup>310</sup> The greatest divergence from the case of U.S.-Japan conflict was that the U.S. sought to focus on the bilateral strategic relationship through the S&ED (which would help a great deal in maintaining confidence in the U.S. system during the global financial crisis) rather than simply deploying pressure tactics, given the vast amount of Chinese holdings of U.S. debt in the form of U.S. Treasury bills. Paulson notes that in the S&ED negotiations, he was candid about the difficulties of the U.S. but mindful that China was one of the top holders of U.S. debt, including hundreds of billions of GSE (government-sponsored enterprise)

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<sup>309</sup> The Minister of Finance at the time was Jin Renqing (金人庆), who served as finance minister from 2003 to 2007. He resigned due to his role in a sex scandal in 2007.

<sup>310</sup> U.S. Department of the Treasury Press Center, 'Treasury Secretary Henry Paulson Press Briefing Following the Announcement of The US-China Strategic Economic Dialogue', HP-108, September 21, 2006.

debt – he stressed that the U.S. understood its responsibilities.<sup>311</sup> Nevertheless, the U.S. agenda of pressuring China to appreciate its currency was inherent since the inception of the dialogues. At the forefront of the U.S. delegation, Paulson was also the right fit for a leading position in the negotiations.<sup>312</sup> Under the Obama Administration, the leadership was handed over to the new Treasury Secretary, Timothy Geithner in 2009. Representing the Chinese side from the year 2008 was former Vice Premier Wang Qishan (王岐山). While Paulson's delegation was comprised of smaller numbers of chief ministers in the Obama Administration cabinet, the size of the Treasury delegation to the economic dialogue led by Geithner to China was significantly larger, reaching a total of 29 government official participants maximum in the May 2011 dialogue.

Domestically, U.S. policy moves on dealing with China had reached its peak in the years from 2004 to 2006. After the Global Financial Crisis that broke out in 2008 which served as a critical point in the U.S. economy, the Obama administration took office, and U.S. pressures on China's renminbi issues declined slowly. While the USTR continuously charged China with unfair trading acts and took USITC and USDOC trade remedy cases to the WTO, and certain congressmen (i.e., Dave Camp, R-MI 4<sup>th</sup> District) steadily pushed the U.S. Treasury to take actions on the renminbi, the U.S. Treasury

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<sup>311</sup> Paulson, 2010. p.52 and p.128. Japan still also holds a considerable amount of U.S. debt, and is the second major foreign holder of U.S. Treasury securities. However, China topped over Japan in 2007 in terms of absolute amount of U.S. debt holdings, which incentivized the U.S. to place policy emphasis on talks with China. For a complete list of major foreign holders of treasury securities from the year 2000, see <http://www.treasury.gov/ticdata/Publish/mfhhis01.txt>.

<sup>312</sup> Paulson, *ibid.* p.32-33. Paulson, with previous years of work experience in China during his time at Goldman Sachs, had built a range of close relationships and contacts with the most senior Chinese leaders, and the investment bank grew to be the leading banking adviser in China at the height of its economic growth. By 2006, Paulson had made about 70 trips to China. His networks (i.e., 15-year bonding with Wang Qishan) in China helped him considerably while he was at U.S. Treasury during the financial crisis.

sought not to overdo the pressure on China's currency policy.<sup>313</sup> The U.S. Congress had China's currency issue on its policy agenda from at least 2003. Although whether the low value of the renminbi was a direct contributing factor to mounting U.S. trade deficits was still debatable, the U.S. Congress carried on a highly politicized debate, as representatives and senators desired to have a solution to respond to the concerns of their constituencies and businesses about the China threat.<sup>314</sup> The U.S. congressional initiatives to pressure China on the issue were magnified and manifested in the dialogues as the process unfolded. However, the U.S. domestic policymaking arena showed incoherence in the process. This policy divide was clearly manifested in the positions of the U.S. Congress and the U.S. Treasury. The U.S. Congress continuously pushed for U.S. Treasury to pressure China by enacting legislations on oversight of exchange rate regimes in 2011 and 2013. On the other hand, U.S. Treasury understood the significance of the agenda of renminbi appreciation, but simultaneously held goals to maintain a sound economic and financial relationship with China as an institution. By declining to name China a currency manipulator, the Treasury took a diverging path from its previous patterns of pressuring Japan, South Korea, or Taiwan.<sup>315</sup> In simple terms, the U.S. Treasury could not afford to be adamant in its demands of renminbi appreciation due to the strong economic

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<sup>313</sup> Ways and Means Committee Hearing on China Exchange Rate Policy, 'Treasury Secretary Timothy Geithner testified about Chinese fiscal policy and progress in talks to revalue the Chinese currency, the Yuan', September 16, 2010 (<http://www.c-span.org/video/?295508-1/china-exchange-rate-policy>). While Geithner's presentation indicated the U.S. Treasury's intent to keep on pressuring China for renminbi appreciation, the congressmen demanded more actions from the U.S. Treasury.

<sup>314</sup> Paulson, *ibid.* p.82. As Secretary of Treasury, Paulson saw the lack of savings by Americans as a bigger factor (than China's cheap exports and huge capital reserves) that caused U.S.-China trade imbalances.

<sup>315</sup> Xinhua News, 'U.S. Treasury declines to name China as currency manipulator', April 3, 2013. [http://news.xinhuanet.com/english/world/2013-04/13/c\\_124575654.htm](http://news.xinhuanet.com/english/world/2013-04/13/c_124575654.htm)

interconnectedness between the U.S. and China.<sup>316</sup> In a CRS Report for Congress on China's currency, Morrison and Labonte also note that while an appreciation of the renminbi against the dollar could help boost U.S. exports to China, it could also entail costs to the U.S. economy in the near term, as China would not need to buy as many U.S. Treasury bills, which could cause real U.S. interest rates to rise. They add that further renminbi appreciation could mean higher costs for U.S. consumers and firms that use Chinese parts for their final products.<sup>317</sup> For the U.S. Treasury, appeasing the Chinese would be in the interest of the U.S. economy and U.S. investors in China in the near term, since the U.S.-China economic relations were interconnected. In the longer term, the U.S. sought to establish and maintain its relationship with China in such a way that a win-win situation would exist between the two, and avoid possibilities of confrontation with China or retaliation from China as much as it could, as the U.S. saw that the centralized Chinese political system embodied less vulnerability to U.S. pressures as the Japanese and South Korean ones did due to their economic and security dependence on the U.S.<sup>318</sup>

**Table 5-7. Developments in the U.S.-China Currency Dispute Timeline, 1994-2013**

<b>Year</b>	<b>U.S. Actions</b>	<b>Chinese Actions</b>	<b>Exchange Rate System</b>
<b>1994</b>		<b>January 1, 1994</b> China devalues official rate – unifies dual exchange rate system	
<b>1996</b>		<b>December 1, 1996</b>	<b>1995-2005</b>

<sup>316</sup> In the Ways and Means Committee Hearing on China Exchange Rate Policy on September 16, 2010, Geithner's response to the committee's requests to take firmer actions against China entails the economic logic that the U.S. should pursue a strategy that is effective in practice, and that an increased pressure may only take away the tools that are present.

<sup>317</sup> Wayne M. Morrison and Marc Labonte, 'China's Currency Policy: An Analysis of the Economic Issues', Congressional Research Service, RS21625, Library of Congress, July 22, 2013.

<sup>318</sup> See Andrew Nathan and Andrew Scobell, 'How China Sees America', *Foreign Affairs*, 91:5, September 2012. The authors argue that while a small group of mostly younger Chinese analysts have positive views on U.S.-China cooperation, such views are outnumbered by confrontational ideas of Chinese strategists about how China should respond to the U.S. Their emphasis on how China sees America in turn influences the ways in which the U.S. policy is shaped.

		China reaches full RMB convertibility	China keeps the RMB pegged to the U.S. dollar at 8.28¥/1\$.
<b>1997-1999</b>		China keeps RMB fixed while neighbors devalue their currencies in the Asian Financial Crisis	
<b>2003-2004</b>	<b>October 2003</b> Treasury Secretary Snow pressures China to allow RMB appreciation through the U.S. Treasury Report		
<b>2005-2006</b>	<b>February 2005</b> Congressional Legislations pressuring China 1) Schumer & Graham <sup>319</sup> 2) Baucus-Grassley <sup>320</sup> October 2006 IMF finds RMB 'undervalued'	<b>July 2005</b> Immediate 2.1% revaluation of the RMB at 8.11¥/1\$ Renminbi appreciates against the dollar.	<b>2005</b> China shifts from peg to managed float. The PBOC sterilizes reserve inflows, preventing excessive money growth and inflation.
<b>2007-2008</b>	U.S. Treasury temporarily passes the RMB-USD debate to the IMF, mandated for exchange rate surveillance	Chinese exporters facing price competition raise complaints regarding export difficulties.	PBOC sterilization falters, money becomes excessive, and inflation becomes a serious issue. Shanghai stock market experiences a bubble.
<b>2008-2009</b>	Global Financial Crisis temporarily raises demand for U.S. dollars		China loses exports, growth slows, and danger of overheating disappears.
<b>2008-2010</b>	President Obama and Secretary Geithner reassure the Chinese on the stability of the USD. <sup>321</sup>  As the financial crisis unfolds, international pressure heightens on RMB appreciation.  <b>April 2010</b> U.S. Congress biannual report (due April 15 2010) finds China guilty of currency manipulation. U.S. Treasury postpones the issuance of the report.  <b>September 2010</b>	<b>Mid 2008-April 2010</b> RMB re-pegged at 6.84¥/1\$ (estimated to be 20% stronger than in 2005) <b>March 2009</b> PBOC Governor Zhou Xiaochuan proposes replacing the USD as international currency with SDR (Special Drawing Rights). <b>November 10, 2009</b> Premier Wen Jiabao urges the U.S. to keep its deficits at an appropriate level lest that the USD may lose its stability (and U.S. T bills that China holds may lose value). <b>April 2010</b> China states it will never bow to pressures from U.S. congressional pressures. China announces to switch to some currency flexibility from June 2010.	China resumes growth. Overheating danger reappears. <b>China returns to fixed exchange rate system.</b>

<sup>319</sup> In February 2005, Senators Schumer and Graham proposed the first of bills to impose tariffs of 27.5% against all Chinese goods if China does not substantially revalue its currency.

<sup>320</sup> Senators Baucus and Grassley also proposed bills substituting the phrase 'currency misalignment' in place of 'unfair manipulation'.

<sup>321</sup> Reuters, 'Geithner tells China its dollar assets are safe', June 1, 2009.

<http://www.reuters.com/article/2009/06/01/usa-china-idUSPEK14475620090601>

	“Currency Wars” by Brazil Minister Mantega warning before G20	<b>November 2010</b> China criticizes the U.S. Fed’s QE2 as an example of currency wars at the G20 Summit in Seoul	
<b>2011</b>	<b>January 2011</b> Obama-Hu Summit Geithner says RMB is appreciating at 10% per year on real terms. October 2011 U.S. Senate passes the Currency Exchange Rate Oversight Reform Act of 2011.		<b>February 4, 2011</b> <b>China returns to managed float.</b>
<b>2012</b>	U.S. Treasury continues not to name China a currency manipulator.		
<b>2013</b>	<b>June 2013</b> U.S. Senate introduces the Currency Exchange Rate Oversight Reform Act of 2013.		

*Source: Compiled by author based on U.S. Treasury reports and U.S. Congressional Hearings.*

#### *China’s Top-Down Decision-making and Exchange Rate Policy on ‘Their Own Terms’*

China’s experience in policymaking in currency matters fared more hierarchical than in the cases of Japan or South Korea’s. While the Japanese technocrats dominated the policymaking sphere, and the South Korean presidency conscious of public opinion influenced policymaking, China’s senior leaders in the top-down political decision-making system would direct the ways in which currency issues would be managed. One of the most prominent Chinese decision makers since Deng Xiaoping’s economic reform era was Zhu Rongji, who served as premier of China from March 17, 1998 to March 16, 2003. During his time in office, he also served simultaneously as the Governor of the People’s Bank of China (PBC), the central bank, from July 1993 to June 1995. Zhu exerted strong leadership during his time, and he would occasionally provide opinions on

economic and financial matters after leaving office.<sup>322</sup> China had readjusted the value of the renminbi by depreciation in 1994, but kept it mostly pegged to the dollar until 2005 when it shifted from peg to managed float (see **Table 5-6**).<sup>323</sup> However, it is notable that China's currency is not fully convertible and capital controls have remained in place.<sup>324</sup>

In response to the U.S. pressures, Chinese policy makers have shown their hierarchical patterns of decision-making, which are different ways compared to the cases of Japan and South Korea. Indeed, there were stark differences, which are mainly circumstantial variances between the cases of U.S.-Japan or U.S.-South Korea trade and currency conflict and the U.S.-China case.<sup>325</sup> But what really made the Chinese case diverge from the two other cases was the way in which decisions are made in the Chinese political system. Indeed, governance and leadership in Chinese politics have evolved over

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<sup>322</sup> Zhu Rongji, 2013. In an interview dated September 27, 2001 entitled 'The Impact of 9/11 on Our Economy, and Our Countermeasures', Zhu comments on the possible effects of 9/11 on China's foreign exchange reserves, and states that for the moment, it is better to keep the renminbi steady by following the dollar instead of opting for linkage of the renminbi to a basket of currencies including the dollar, yen, and euro. Eventually, China shifted from peg to managed float in 2005.

<sup>323</sup> Rickards, 2011. pp.101-102. Up until 1993, China had engaged in a series of six devaluations from 1983 to support its booming exports. On January 1, 2014, China announced a reform of foreign exchange system and devalued the renminbi at 8.7 to the U.S. dollar, which prompted the U.S. Treasury to label China as a currency manipulator.

<sup>324</sup> Patrick Hess, 'China's Financial System: Past Reforms, Future Ambitions and Current State', in F. Rövekamp and H. G. Hilpert eds., *Currency Cooperation in East Asia*, Financial and Monetary Policy Studies, Springer, 2014.

<sup>325</sup> The Chinese viewpoint on the differences were made quite transparent when former Chinese Vice Premier Wang Qishan described the differences and argued that the comparison is inappropriate on a U.S. talk show hosted by Charlie Rose, in a session he attended with Secretary Geithner that was nationally televised in the U.S. on May 15, 2011. He identified five differences between the U.S.-Japan and U.S.-China conflicts, the first two of which were mentioned to him by Larry Summers and the third by a Japanese central bank governor (unidentified): first, that Japan's technology at the time was at or above that of the U.S., while China's technology lags behind; second, that brand recognition by U.S. consumers of Chinese firms is scarce; third, that generators of trade surplus on the Japanese side were mainly Japanese firms, but multinational corporations and foreign investors from developed countries in the case of Chinese surpluses; fourth, that the U.S. had not deployed export controls on Japan while it has on China based on security reasons; and fifth, that the U.S. does not recognize China as a market economy. Although Wang's intention behind pointing out the differences were not made explicit, mentioning the factors made the Rose and Geithner nod in agreement and at least appeared as an gesture to imply that China is not a culprit of the conflicts that have risen between the U.S. and China, whereas Japan may have been in the U.S.-Japan case.

time, impacting the policy decision-making process. After Deng Xiaoping's reform era, China has developed a responsive authoritarianism through representation at the highest reaches of the CCP, which balances geographic, functional factional, and policy interests.<sup>326</sup> The pluralism seen in Chinese bureaucracy is geared toward accommodating as many interests as possible, albeit through the ultimate projection of power at the highest level of the decision making process, which is the Politburo. The Politburo Standing Committee (PSC), led by the Chinese President, is composed of several vice premiers, and it serves as China's highest leadership body and ultimate economic and financial decision-maker. Party authority over the financial system is exercised via the Central Organization Department that appoints the heads of all major institutions and also via the Leading Group for Financial & Economic Affairs (中共中央财经领导小组: *hōnggòngzhōngyāng cáijīng lǐngdǎo xiǎozǔ*).<sup>327</sup> As mentioned in previously in Chapter 2, for domestic and foreign economic policy making, the Leading Group for Financial & Economic Affairs leads the policy formulation.<sup>328</sup> The battlefield of interests in the bureaucracy has become apparent in the form of "small leading groups" (*lǐngdǎo xiǎozǔ*). Currency and exchange rate policies are no exception to the current patterns of top-down bureaucratic policy formulation.

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<sup>326</sup> Lampton, 2014. p.70.

<sup>327</sup> Hess, *ibid*.

<sup>328</sup> The Leading Group for Financial & Economic Affairs was led by Zhao Ziyang (1980-1989), Jiang Zemin (1989-1998), Zhu Rongji (1998-2003), Wen Jiabao (2003-2013), and is currently led by Premier Li Keqiang (2013-present). Other than the leader Li Keqiang, current composition of the group include policymakers such as Zhang Gaoli (First-Ranked Vice Premier) as the Deputy leader, and members including Wang Yang (Third-Ranked Vice Premier), Ma Kai (4th Ranked Vice Premier), Wang Yong (Chairman of the State-owned Assets Supervision and Administration Commission, SASAC), and Zhou Xiaochuan (Governor, People's Bank of China).

While little is known about how policy decisions are made in the small leading group, but it is evident that decisions made in the group are sent down to the policy practitioners, e.g., the finance ministry and the central bank. It is worth noting that the Chinese state's control over matters pertaining to currency and finance derives from the traits of the Chinese financial system, which is still predominantly state-owned, with the state completely owning most banks or holding majority of stakes in the banks. In addition, according to Hess (2012), the CCP relies heavily on government performance and not ideology for political support by its people as it did in the past, and the CCP leadership understands very well that the lack of government performance may undermine the party's position in governance. Exchange rates that influence China's economic output in exports matter a great deal, and thus currency issues are crucial matters for the leadership.

On political terms, China firmly refused to change its exchange rate policy solely owing to U.S. demands and conditions – it denied any sort of currency manipulation, and it maintained its agenda of continuing economic growth. Fundamentally, the Chinese approach would be that currency issues would be at the Chinese discretion under their own terms, but that they would be willing to carry on talks with the U.S. to seek mutual interests and further economic partnership. China's ultimate policy choice was to keep identifying new bargaining chips as its negotiation with the U.S. unfolded, by simultaneously redefining their interests at each point of negotiation, depending on the economic and financial circumstances.<sup>329</sup> For instance, at the S&ED in May 2007, Wu Yi

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<sup>329</sup> These traits in Chinese negotiation style was clearly manifested in April 2010 when the U.S. Congress urged the U.S. Treasury to identify China guilty of currency manipulation but the Treasury chose to postpone the issuance of the report (See Table 5-6.) At the time, China announced that it would not bow to

would refuse Paulson's request to raise the equity caps that limited the percentage of foreign ownership in Chinese financial institutions, but would consent to Paulson's persuasion on syncing the renminbi with the dollar, backed by the supporting argument that holding a currency that reflected market reality would be a key to China's continued economic reform and progress, and to alleviate mounting inflationary pressures in China.<sup>330</sup> In some occasions, in the escalation to the Global Financial Crisis in 2008, the U.S. would find itself asking the Chinese for understanding and help. In the preparatory meeting for the June 2008 S&ED, the focus of the conversation between Paulson and Wang Qishan was on U.S.-China energy cooperation, but Wang's primary interest was in the problems surrounding the U.S. capital markets, and Paulson reassured him that the U.S. understood its responsibilities.<sup>331</sup> On September 17, 2008, when the U.S. market was in panic and Morgan Stanley was under siege, Paulson would be asked by Morgan Stanley to contact Wang Qishan to see if the Chinese would be willing to invest to save the company from failing.<sup>332</sup>

Overall, in the Chinese political system, a hierarchical system dominated by a small number of senior leaders – as opposed to the technocrat-dominated system in Japan and the system driven by the presidency in South Korea – was in operation at the time of

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the pressures but both the U.S. and China saved faces by the U.S. postponement of the report and Chinese acceptance of allowing currency flexibility from June 2010, and transitioning back to managed float in February 2011.

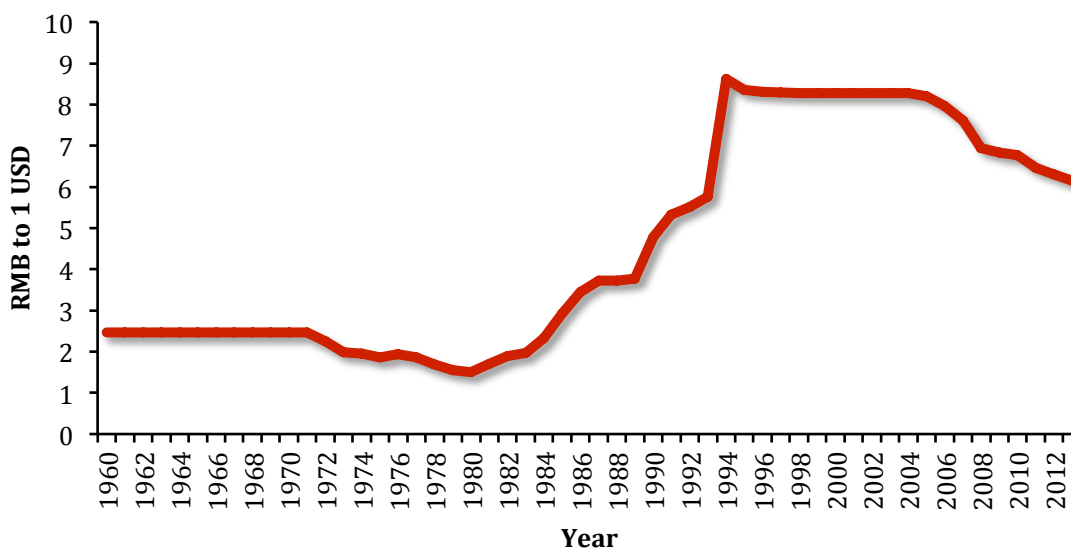
<sup>330</sup> Paulson, *ibid.* p.82.

<sup>331</sup> Paulson, *ibid.* p.128.

<sup>332</sup> Paulson, *ibid.* p.245. At the time, the Chinese Investment Corporation, China's sovereign wealth fund, already owned 9.9 percent of Morgan Stanley. Mitsubishi UFJ Financial Group was also a potential strategic investor, but Paulson was skeptical that a Japanese bank could move quickly enough for Morgan Stanley's pressured situation. As it turned out, Morgan Stanley ended up having to talk directly with then Chinese president Hu Jintao. (See Paulson, p.271)

U.S.-China currency conflict. In the Chinese system, the small leading group of senior political leaders in charge of economic and financial policies at the top of the decision making system exert immense amounts of power that trickles down to the relevant ministries and agencies. In the case of currency related negotiations, the negotiators of the Chinese delegation led by Vice Premier Madame Wu would act as the mouthpiece of the leadership, and the central bank would be the agent that implements policy choice with regard to exchange rates.

**Figure 5-3. RMB-USD Exchange Rates (1960-2013)**



*Source: By author based on exchange rate data from the Federal Reserve Board foreign exchange rates*

## **Conclusion**

The chapter mainly investigated the factors to the varying patterns of policy negotiations and responses toward the U.S. pressures. In retrospect, U.S. bilateral trade deficits with East Asian economies since the early 1970s have led to imposition of U.S. political pressures on each of the East Asian countries at different points in time. The

U.S. policy intent was to place currency appreciation pressures on East Asian countries with current account surpluses, particularly those that maintained currency and capital controls under highly regulated financial systems. In the case with Japan, policy decisions were made discreetly with the MOF acting as the chief bureaucratic actor; in South Korea, the strong presidency would direct the ways in which the bureaucratic actors would make policy decisions for the responses; and in China, a small group of leaders in charge of economic and financial matters would discuss the currency issues and their decisions would be reflected in the bilateral negotiations with the U.S. via the delegation. Often times, each of the East Asian currency negotiations with the U.S. involved U.S. requests and coercions toward the promotion of financial liberalization and further deregulation. In evaluating each of the East Asian responses to U.S. currency appreciation pressures, there were distinct patterns of decision-making. Japan's MOF strategically acquiesced to U.S. pressures in appreciating the Japanese yen for multiple bureaucratic reasons, to retain their budgetary power within the bureaucracy and to become the principal negotiator in matters relating to currency; South Korea's decision making process was predominantly at the hands of the presidency significantly weary of the public eye with the MOF acting as the agent, at times reciprocating to U.S. demands without a thorough strategic planning; and Chinese economic leaders, holding their cards, was in utter denial of any currency manipulation in the beginning, which did allow incremental currency appreciation but only under their own terms, bargaining with the U.S. at each point.

The three countries carried out their policy making process as responses to U.S. currency appreciation pressures in distinctive patterns of calculations and actions. Of all of the three countries, Japan's acquiescence in the 1985 Plaza Accord was not only a product of Japan being coerced into U.S. requests, but also Japan's strategic calculations to position itself amongst the world's major economies at the time via currency realignment.<sup>333</sup> Internally, the MOF's interests in becoming the main channel for negotiation and streamlining the participants into two entities – the MOF and the U.S. Treasury – was intended to strengthen its institutional role and authority within the Japanese bureaucracy via policy dominance. In comparison, Japan received by far the strongest pressures from the U.S. amongst the three East Asian states both by the U.S. Congress and the U.S. Treasury, while China received stronger pressures from the U.S. Congress than the actual negotiator – the U.S. Treasury. U.S. pressures on South Korea were relatively lower in degree in comparison to those imposed on Japan and China.

Japan's behavior in currency negotiations with the U.S. could be summarized as strategic acquiescence – once it perceived U.S. pressures, Japan's MOF acknowledged the difficulty of deflecting from the pressures, and sought to gain the most out of a negotiation via cooperation, thereby showing patterns of strategic acquiescence. South Korea's responses to the U.S. pressures could be characterized as reluctant reciprocation in lack of strategic choice, mostly because it was swayed by political decision-making by the presidency – like Japan, South Korea knew for certain the slim chances of deflecting from U.S. pressures, but it was very ill-prepared for negotiations and simply resorted to

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<sup>333</sup> Personal interviews with a former MOFA official, 2010.

defensive responses without opting for alternative options, thus resulting in obscurity of objectives, lack of strategic thinking and accountability. In many ways, China's case diverged from the cases of Japan and South Korea. China was in a very different situation compared to the previous cases of Japan and South Korea – it was able to behave very flexibly on the fundamental understanding that U.S.-China economic relations are symbiotic.<sup>334</sup> On the charges of currency manipulation, China has been very adamant about its position to plead innocent, but the Chinese leadership has come to terms with the U.S. via incremental appreciation, based on the realization and understanding of the necessity of developing the Chinese domestic economy in tandem with the export economy, and only in the presence of its strategic planning for policy direction at each point of negotiation.

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<sup>334</sup> Paulson, *ibid.* p.422. Former President Hu Jintao's remarks at the concluding meeting of the S&ED in December 2008 is a clear reflection of China's flexibility and understanding of the U.S.-China economic interdependence, in which he said, "We didn't move as fast in a number of areas as you wanted us to, but we don't vacillate, and we will continue with reform and opening up."

## CHAPTER SIX

The Change of Tides:  
The Future of U.S.-Northeast Asian Trade Wars and Currency Conflicts

"95% of the world's potential customers live outside our borders. Many of them live in the Asia-Pacific—the world's fastest-growing region. And as we speak, China is trying to write the rules for trade in the 21st century. That would put our workers and our businesses at a massive disadvantage. We can't let that happen. WE should write those rules."

-President Barack Obama,  
*'Weekly Address: We Should Make Sure the Future Is Written by Us'*  
February 21, 2015-

"I want us to ask ourselves every day, how are we using technology to make a real difference in people's lives."

-President Barack Obama,  
*'On Digital Government, The White House'*

### **The Future of U.S.-Northeast Asian Economic Relations**

As we head towards the year 2020 as of this writing, there are movements in the global political economy that counter the movements by China – namely, further expansion of its economy that impacts the rest of the world in all parts of the globe. The year 2020 is the year in which experts and analysts have forecasted that China is expected to surpass the U.S. as the world's largest economy.<sup>335</sup> While it is highly probable that China may not be equipped with the ample science and technology to surpass the U.S. by then, the question of size – the impact of the Chinese economy on the global economy at a greater scale – poses threats and concerns to many in the U.S. policymaking world. Losing the lead to China would be the last thing the U.S. wants. For the United States, it is a critical point in time to realize that trade wars and currency conflict with China cannot be overlooked. From the perspective of U.S. policymakers, it is crucial to understand that China today is different from any other.

Throughout the previous chapters, I have argued that each of the U.S.-Northeast Asian trade wars and currency conflicts are inherently different, stemming from *institutional variance* amongst the countries. As repeatedly argued, political capacity and industrial interests, which are the main pillars that create institutional variance, and the historical development of political systems and economic structure of each country is the very root of a country's institutions. What I am seeking to arrive at is not whether a country's system or institutional mechanism is perfect or appropriate, and furthermore, I am not

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<sup>335</sup> 'By 2020, China No. 1, US No. 2', Forbes, May 26, 2011. Predictions that China will surpass the U.S. by 2020 are by Standard Chartered Bank economists and other analysts at the International Monetary Fund. <http://www.forbes.com/sites/kenrapoza/2011/05/26/by-2020-china-no-1-us-no-2/>

seeking to argue that a country's case is superior to another. Nonetheless, acknowledging the differences among systems matter, because it helps us to better understand the causes of the differences. Beyond the question of good and bad, the real takeaway from this research is that when we ask *how countries make decisions*, it is important to find the roots of a country's decisions based on the characteristics of their institutions. Thus, institutional variance provides the key answer as to *why countries make decisions differently, and why country responses vary*.

### **Revisiting the Themes Visited – Trade Wars and Currency Conflict**

Albeit in different time periods, this research provided an overview of how each East Asian state behaved at a critical time point in their development phases with regard to economic clashes with the United States. Through the case study analyses on U.S.-Northeast Asian trade wars – bilateral trade negotiations between the U.S. and each of the East Asian states, antidumping and countervailing duty measures by the USDOC and USITC, and U.S.-initiated WTO dispute settlement cases by the USTR at the WTO DSB – we learn that despite the conventional wisdom that security interests override economic interests; or simply that as U.S. allies, Japan and South Korea will succumb to U.S. pressures while China is expected to behave otherwise; there is a more compelling driving force that leads to each of their final policy decision-making or behavioral patterns. The point of the argument is more about how institutions – based on what grounds of political systems and nexus of government-business relations – make decisions. On currency conflict, each of the bilateral negotiations that were convened to appreciate the value of local currencies in Northeast Asian states also tell us that the

responses by each state stem from their institutional decision-making – the interconnectedness, internal and external interactions, conflict and cooperation among political actors, bureaucracies, and industries in the political and economic environment in a certain time frame in history.

My model of institutional variance is noteworthy in the regard that it provides a simplification of intertwined interests that can often mislead observers of U.S.-Northeast Asian relations, especially that of economic relations. Admittedly, in the policy world, the focus on U.S.-Northeast Asian relations today is still on military or security issues, and the continued focus on security makes it fairly difficult to segregate the political economy portion of the dynamics from the security logic, or discussing political economy at all without engaging in issues of national defense and security alliance. My model, intended to provide a concise explanation for institutional behavior in each country in foreign economic decision-making, is certainly not intended for oversimplification, let alone false perceptions. Rather, it is a breakdown of what we actually perceive in foreign-economic policymaking by the three countries, from both macro and microscopic viewpoints focusing on the institutions.

While the minutiae of Chinese, Japanese, and South Korean decision-making platforms may not seem applicable to other such platforms, the model I have presented depicting institutional variance with regard to a certain objective in the policymaking process among multiple countries may be applicable to different cases around the globe. In the longer run, such cases may arise for Southeast Asian or Latin American nations in trade negotiations with the U.S. Moving forward, my model may be applicable to

different regions of the world – i.e., the institutional variances that may occur in shaping different policy responses in the developed world such as Europe, or among the developing economies of BRICs.

In our complex and constantly changing world, the model of institutional variance that I have demonstrated in this research is a guiding light and method of observation for any that seek to read the policy intent behind statecraft and policy decisions made by nation states. Today, however globalized the world may be, decisions of a state's external relations are, in the end, made by institutions of the state, and diplomacy is shaped by political actors at the summit levels. Therefore, my model of institutional variance is attested by the ubiquitous and numerous actions by nation states in the global political economy that shape the world that we live in around the clock, and the growing necessity in the real world to dissect and interpret each of their actions. What is more, it helps us to get to the fundamental characteristics of each state behavior and prevents us from being swayed by stereotypical thinking or observations of a certain country.

Institutions, like living organisms, evolve over time, but they are also strongly embedded to a political mindset and rooted by their history of economic development. Therefore, when institutions evolve, societies also evolve to adapt to the changes, and *vice versa*. Some thrive, and some die out. Some remain influential or gain more power, and some lose the ability to make impactful policies. But the core of the institutional mechanisms remains, and each institutional mechanism is both reflective of the state and distinguishable from others.

### **The Change of Tides**

Twenty years have passed since the Marrakesh Agreement of 1994 as a result of the Uruguay Round, and the establishment of the World Trade Organization in 1995. In between that time period of two decades, the accession of China to the WTO in 2001 based on the U.S. Congressional granting of PNTR status to China has made all the difference in the global political economy. Whether the Chinese will take over the American economy is still uncertain, but China has undoubtedly made a clear impact on the global political economy, and will continue to do so. Over the past 15 years, since its entry to the global economy, although China has not been able to change or break the rules, it has changed the dynamics of the game. But now it wants to make its own rules, or change the current rules to its interest, starting from domestically. China's intent is not solely about overcoming the so-called 'century of shame', but more in aspiration and restoration of power. China understands that in today's world, economic power is the source of real power and hegemony.

#### *The Trans-Pacific Partnership Negotiations*

While the structure and norms of trade in the global political economy are still set at 1994, so much has changed over the past two decades. The rise of the Chinese economy is one, and the continued soaring of U.S. trade deficits is another, as underlined in this research. But there are additional factors that are creating a shift in the global economy today. One is the proliferation of regional or bilateral free trade agreements (RTAs, FTAs), and bilateral investment treaties (BITs). These agreements are negotiated, signed, and ratified by parties outside of the WTO framework, and have taken trade agreements to a different level in the past twenty years. While the WTO DSB system is surely here to

stay in ruling for violations or non-violation claims by WTO members, it is not certain whether the current WTO system will be able to effectively address and accommodate the changes in the global economy in the coming years.

The proliferation of RTAs and FTAs have indeed set the background for the Trans-Pacific Partnership (TPP) negotiations, a cross-regional framework for trade in which the U.S. and Japan are parties to. What started off as a small group in the name of Pacific Three Closer Economic Partnership (P3 CEP) is now the TPP membership, driven mainly by the United States, consisting of twelve member states situated along the Pacific Rim – the U.S., Canada, Mexico, Chile, Peru, Australia, New Zealand, Japan, Singapore, Brunei, Vietnam, and Malaysia. South Korea and Taiwan have expressed interest in joining the TPP in 2013, but was told to join at a later time frame after the negotiations have been finalized. With both geopolitical and economic interests met, the TPP, if concluded and taken into effect, could reshape the dynamics of U.S.-Northeast Asian economic relations.

There are two additional factors – geopolitical and economic – that have led to the U.S. drive for the TPP negotiations. The geopolitical factor is the U.S. willingness to counter further expansion of the Chinese economy by forming a regional partnership excluding China, thereby exerting continued influence in the Asia-Pacific region. The economic factor derives from the changes in the U.S. economic structure toward a services sector-oriented economy and its urgent need to protect the intellectual property of U.S. businesses abroad, especially in China. By inserting provisions concerning trade, investment, and intellectual property that are beyond China's capacities to follow at the moment, the U.S. is seeking to mobilize its interests in the Asia-Pacific first, then compel

China to follow the rules. It has been reported that China also has speculated its options of joining the TPP, but such reports has not come into policy action. Meanwhile, China's geopolitical and economic interests, particularly those concerning Southeast Asia, are manifested by its initiatives taken in the Regional Comprehensive Economic Partnership (RCEP) – which is a trade agreement encompassing China and ASEAN countries; and most recently, the Asian Infrastructure Investment Bank (AIIB) – an entity equivalent to the World Bank for the Asian region.

#### *Changing Global Economic Structures and Trade Negotiations*

There have been big changes in the global economic structures in the past two decades. The most salient structural change is the growing emphasis on the services sector in the developing world. To elaborate further, in the U.S. and the EU, the services sector is now a crucial driving source that sustains economic growth. As much as the services sectors are in the spotlight, the importance of intellectual property (IP) has emerged. The global economy has faced difficult situations in establishing a firmer regulatory regime on intellectual property – one that is more reinforcing global consensus on IP since the Trade-Related aspects of Intellectual Property Rights (TRIPS). At this backdrop, the current TPP and Transatlantic Trade and Investment Partnership (TTIP) negotiations include debates on intellectual property chapters that go beyond the current global norms on IP as stipulated in TRIPS.

We now live in the world in which we upload information to be shared online, As the global economy goes through power shifts in the digital revolution era, issues involving cloud convergence, online and offline IP, e-commerce, cross-border transactions will

become all the more important. What seems very apparent at this point is that there is no way a global consensus could be made as in the Uruguay round on such issues, because there is a big policy implementation gap among the developed world and the developing world. The U.S. is addressing trade issues in response to the changes in global economic structures via two different directions – through the TPP and the TTIP negotiations.

While the IP chapter in the TTIP embodies several issues on copyright (i.e., performance rights) and trademark (i.e., geographic indication) to level the playing field between the U.S. and Europe, the IP chapter in the TPP is intended by the U.S. to bolster the enforcement of IP in TPP member countries in which IP regulations are more lax, particularly in Southeast Asia, and to persuade countries that are currently not participating to join. In the longer run, the U.S. is very likely to envision incorporating the two regional partnerships for negotiation at the global level. Although the failure of the Doha Round is proof that the division of interests between the developed world and the developing world will continue, it is very plausible that the developed world – led by the U.S. – will continuously attempt at combining regional initiatives for a full-fledged global initiative in the coming decades.

#### *Currency Conflict after the Global Financial Crisis*

The Global Financial Crisis (GFC) and quantitative easing in the developed world in response to the crisis ignited a series of competitive devaluation. The questions remain as to how far the U.S. will go for currency appreciation pressures against China, as China

has been keeping its currency artificially strong in recent years.<sup>336</sup> While there are speculations and expectations on China's reversal of its current policy of maintaining a strong currency, it is undoubtedly for certain that China's monetary policies are not subservient to U.S. pressures, but rather, more faithful to its political logic and economic conditions at home. In the Asian region, countries have shied away from engaging in a full-scale currency war after the GFC, but it is quite clear that Japan is very anxious and sensitive to the changing of tides with the rise of the Chinese economy. Japan's long-contemplated decision to join the TPP negotiations was made in large part for its economic and geopolitical survival via balancing against China and siding with the United States. Meanwhile, South Korea seeks a balance between the U.S. and China in both economic and security relations.

As China continues its journey for renminbi internationalization and pursues exuding greater influence over the global political economy, its Northeast Asian neighbors will strive to choose their paths between conflict and cooperation with China, and also with the U.S., which will continue to restore its influence in the region economically and militarily. It remains a question as to how much China will be able to incorporate the rest of the East Asian region other than its neighbors; namely, the ASEAN countries. While China presents an economic challenge as well as opportunity for them, China's continued expansion into the Southeast Asian economies bring about standoffish responses amid maritime tensions that create geopolitical conflict.

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<sup>336</sup> 'China's Exchange-Rate Policy: Currency peace – Devaluing the yuan would do China more harm than good', *The Economist*, February 21, 2015 ([http://www.economist.com/news/finance-and-economics/21644205-devaluing-yuan-would-do-china-more-harm-good-currency-peace?fsrc=scn/tw\\_ec/currency\\_peace](http://www.economist.com/news/finance-and-economics/21644205-devaluing-yuan-would-do-china-more-harm-good-currency-peace?fsrc=scn/tw_ec/currency_peace))

## Avenues for Future Research

### *Trade Negotiations in the Digital Revolution Era*

In relevance to my research, the most pressing area for research is on the changing dynamics of trade negotiations in the digital era. There are several areas regarding the transition from analog to digital in which further research must be convened to uncover the negotiation patterns in the 21<sup>st</sup> century. How trade negotiation platforms, methods, and interactions amongst parties in the negotiation evolve in the growing presence of NGOs, activists, interest groups, and open information. Although the current TPP and TTIP negotiations, and most FTA or BIT negotiations occur behind closed doors, citizens and interest groups around the world have learned to express their opinions regarding trade negotiations that are conducted in a *fait accompli* manner. For instance, the revealed IP chapters and country positions on each of the provisions and chapters of the TPP negotiations were uploaded and distributed via the WikiLeaks website by an informer. Such an example clearly demonstrates the difficulty of maintaining confidentiality in trade negotiations the 21<sup>st</sup> century.<sup>337</sup> The widespread presence of social media such as Twitter and Facebook that mobilize certain types of interests, report on updates on ongoing trade negotiations, and bring about citizenry responses to the revealed information from around the globe make trade negotiations led by government institutions very tough deals to strike. While it is indeed the case that the format of negotiations and diplomatic relations today still carry on and stem from those of yesterday, how trade negotiation dynamics will change in the 21<sup>st</sup> century in the midst of

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<sup>337</sup> Updated Secret Trans-Pacific Partnership Agreement (TPP) - IP Chapter (second publication), WikiLeaks. <https://wikileaks.org/tpp-ip2/>

online and offline information space would be of critical interest for observers of international political economy.

*Evolution of Institutions in the Age of Science and Technology*

Lastly, another important avenue for future research is on how institutions, both in East Asia and the United States, will evolve in the in the era of digital revolution. The U.S. has already launched an initiative for digital government in purpose of building a 21<sup>st</sup> century government platform that mobilizes nationwide information and participation by its citizens.<sup>338</sup> South Korea has been also testing the waters for e-government from the Roh Moo-hyun administration. The Japanese and Chinese governments are lagging in terms of developing and perusing the e-government system, but are slowly following the trend, although China's still lacks transparency and efficiency. The proliferation of e-government in many different countries will change the forms of decision-making processes, affect the manner in which bureaucratic procedures are held, more so by expediting the processes. However, the constant battle between reveal of information and citizen participation will pose both challenges and opportunities for institutions in the coming decades.

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<sup>338</sup> 'Digital Government: Building a 21st Century Platform to Better Serve the American People'  
<http://www.whitehouse.gov/sites/default/files/omb/egov/digital-government/digital-government.html>

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