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# WHEN SECURITY HURTS: CHINA - THE MASTER OF “COVERT” SANCTIONS

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*In the summer of 2016, the South Korean government announced that the US-ROK alliance had agreed to work together on the installment of one Terminal High Altitude Area Defense (THAAD) system battery in order to guard itself against potential nuclear threats from North Korea. Despite Chinese claims to not have enforced any sanctions with regards to South Korean economic activities in Mainland China following the installation of the THAAD system, it quickly became evident that the Chinese government was making conscious efforts to hinder economic endeavors by Korean entrepreneurs and companies in China. This paper utilizes economic sanctions theory in order to investigate the covert nature of the Chinese government’s attempts at punishing South Korean businesses for political initiatives undertaken by the Korean government. The paper will proceed in two parts. The first part introduces the literature on economic sanctions theory and its utility in the Chinese context and proceeds to account for the political events leading up to and following the deployment of the THAAD system in South Korea. It especially aims to emphasize Chinese reactions to the rationales and actions of the South Korean government, using primary sources and statements made by Chinese officials involved in the matter. The second part of the paper consists of a case study of Korean pop manufacturer SM Entertainment, in which the THAAD deployment’s effects on SM Entertainment’s activities in Mainland China will be accounted for. Utilizing primary and secondary sources, the second part of this paper presents data, which argues that SM Entertainment was not observably affected by the crisis, but that it also made deliberate efforts to redirect its activities to Japan following the THAAD deployment, in response to severe restrictions on Korean popular culture products in China. Findings reveal that the Chinese government not only has a significant history of enforcing covert sanctions against sovereign nations in response to political decisions made by their governments, but that it also is highly likely to continue this form of punishment, in an attempt to influence foreign politics without running the risk of military escalation or further conflict.*

## Introduction

Following a series of nuclear tests in North Korea in 2016, tensions increased on the Korean Peninsula, leading South Korea and the United States to deploy the Terminal High Altitude Area Defense system (henceforth referred to as THAAD) as a means to amp up security measures against the DPRK. As China expressed serious concerns regarding the deployment due to its significant increase in radar visibility and reach, the immediate cancellation of several Korean pop artists' tours in China revealed an apparent overlap of national security issues and economics. This paper investigates the Chinese view of the THAAD deployment and the subsequent actions taken by the Chinese government against South Korean musicians and performers' activities in China. Utilizing economic sanctions theory and the case study of pop culture manufacturing giant SM Entertainment, this paper illuminates the observable effects of indirect economic sanctions on South Korea through the illustration of SM Entertainment's redirection of their artists' activities in Mainland China to Japan. Despite Chinese claims to not have enforced any sanctions with regards to South Korean economic activities in Mainland China, this paper argues that the Chinese government made covert attempts at punishing the entertainment industry for a political decision made by the South Korean government.

## Economic Sanctions in Theory

Economic sanctions theory has mainly been led by discussions of whether or not economic sanctions work and, if so, under what conditions they work better than others. For contemporary scholars, the consensus has mostly been that sanctions do not work.<sup>1</sup> Hovi, Huseby and Spring identify three main characteristics of economic sanctions that render them difficult to impose. First, it is difficult to properly ensure that sanctions hurt where they are meant to hurt. Next, sanctions may have costly effects on the imposer and may even affect neighbors of the target state or the imposing state itself. Finally, sanctions may cause the 'rally around the flag' effect, further arousing popular support for the regime it is meant to target or undermine.<sup>2</sup> However, this consensus has been dominated by the dichotomous orientation of economic sanctions as either successful or failures rather than as a degree of success and failure. Rather than asking whether sanctions work in general, Mastanduno argues that one must instead ask under what circumstances or conditions economic statecraft is a *feasible option* to realize one's objectives.<sup>3</sup> Economic sanctions are built upon the foundational logic that intense pressure

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1 Jon Hovi, Robert Huseby, and Detlef F. Spring, "When Do Economic Sanctions Work?" *World Politics* 57, no. 4 (2005): 80

2 *Ibid.*, 480-481.

3 Michael Mastanduno, "Economic Statecraft, Interdependent and National Security: Agendas for Research," *Security Studies* 9 no.1-2 (1999): 292.

on a target's economy may eventually lead to the target government capitulating. Economic pain, however, does not necessarily translate directly into political gain, and thus Mastanduno argues that there is no linear relationship between economic pain and political winnings.<sup>4</sup> David M. Rowe argues for a more objective-oriented approach to sanctions. Rather than dichotomizing failure and success, he calls for more focus on what the actual objectives for economic sanctions are and what their imposition is then meant to achieve.<sup>5</sup> He believes that a proper identification of the reasons and purpose of their imposition is crucial to the study of sanctions because it naturally is impossible to declare something a relative failure or success if one has failed to properly identify the logic behind said economic sanctions in the first place. The two authors of the most dominant, contending viewpoints on the effectiveness of economic sanctions, David A. Baldwin and Robert A. Pape, define as instruments of statecraft and as strategies for the use of instruments of statecraft respectively. Pape in particular emphasizes the need to separate economic sanctions as strategy from the strategies of trade war and economic warfare because each of them brings about the realization of different goals.<sup>6</sup>

Baldwin contends Pape's strict view of economic sanctions because he does not believe that a broad definition of power to include military and economic power will erase the distinction between the two.<sup>7</sup> He pushes for the definition of economic sanctions as encompassing all forms of economic means "by which foreign policy makers might try to influence other international actors."<sup>8</sup> In this view, economic sanctions can then include not just measures taken to achieve one specific end goal, such as coercion in trade disputes or the reduction of the target state's military, but also the subtler acts of illustrating resolve or inflicting punishment. He also between imposing economic sanctions as an undertaking and making a target state pay a price for noncompliance as an outcome. As such, Baldwin's approach allows for *degrees* of success rather than a dichotomy of failure or success as in Pape's view.<sup>9</sup>

Baldwin introduces the assumption of policymakers as rational by discussing the use of economic sanctions vis-à-vis other tools of statecraft as a rational calculation of cost-benefit. He argues that when policymakers decide whether to use economic sanctions or not, it is not a matter of whether economic sanctions can alter the target state's behavior without the use of military force but rather whether economic sanctions have more utility than military force may be likely to. Here, it is thus a matter of comparative utility and not solely of the comparative effectiveness of military force or economic sanctions. Baldwin emphasizes that it is therefore

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4 Mastanduno, "Economic Statecraft, Interdependent and National Security," 294.

5 David M. Rowe, "Economic sanctions do work: Economic statecraft and the oil embargo of Rhodesia," *Security Studies* 9, no. 1-2 (1999): 255.

6 David A. Baldwin and Robert A. Pape, "Evaluating Economic Sanctions," *International Security*, 23 no. 2 (1998): 189.

7 *Ibid.*, 191.

8 *Ibid.*, 196.

9 Baldwin and Pape, "Evaluating Economic Sanctions," 192.

quite possible for sanctions to prove themselves more useful than military force, even in situations where they are comparatively less effective.<sup>10</sup> This argument is further developed in a later article published by Baldwin in *International Security*. Here, he emphasizes that when discussing the effectiveness of a policy choice, it is important to consider the policy choices (in this case, economic sanctions) costs and benefits in comparison to the costs and benefits of other options (military action, for example).<sup>11</sup> Baldwin writes: “from the standpoint of the logic of choice, any discussion of economic sanctions that fails to compare their likely cost-effectiveness with that of alternative courses of action provides no useful policy guidance with respect to deciding whether sanctions should be used in a given situation.”<sup>12</sup> In this view, rather than seeing the options for action in isolation and as alternatives to one another, he calls for a proper analysis of exactly what these ‘alternatives’ may cost, relative to a policymaker’s other options. Put differently, rather than expecting that policymakers consider sanctions as an *effective* tool, one ought to consider the use of sanctions as depending on the expected utility of said sanctions relative to a policymaker’s other options. As Baldwin observes, the rationale for the use of sanctions is “*more likely to rest on the high cost of the alternative of military action, than on a naïve expectation that sanctions will be effective.*”<sup>13</sup> As such, the imposition of sanctions is not necessarily to obtain great diplomatic ‘victories’ but because they are cost effective. Employing sanctions even when their expected success is low is not irrational, provided that the expected utility of other options is even lower.<sup>14</sup> As economic sanctions are a form of statecraft, their utility must thus be considered relative to other such forms of statecraft: military force, diplomacy and propaganda.<sup>15</sup>

### Chinese Economic Diplomacy in Action

Chinese economic diplomacy has, until recently, been mostly exercised in South and North East Asia, and its willingness to use economic sanctions and trade restrictions as a means of statecraft has been illustrated on several occasions. In 2003, it shut down an oil pipeline to North Korea, arguably to pressure the North Korean regime into attending a Beijing-hosted trilateral meeting on denuclearization. In 2010, it imposed massive bans on Norwegian salmon following the Nobel Peace Prize being awarded to Liu Xiaobo. It has also suspended exports of raw materials to Japan following the detention of a Chinese fishing boat captain by Japanese authorities in 2011. It imposed restrictions on banana imports from the Philippines

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10 Ibid., 194.

11 David A. Baldwin, “The Sanctions Debate and the Logic of Choice,” *International Security* 24, no. 3 (1999-2000): 85.

12 Ibid., 86

13 Ibid., 99.

14 Baldwin, “The Sanctions Debate and the Logic of Choice,” 106.

15 Ibid., 92.

in 2012 due to territorial disputes in the South China Sea and more recently in 2017 by restricting oil exports to North Korea following nuclear tests. This led to the subsequent implementation of UNSCR sanctions. In all of these cases, however, the Chinese government, or representatives hereof, have denied imposing any such sanctions, giving causes such as “technical difficulties” or “concerns about whether payment would be made” in order to explain the actions taken at the time.<sup>16</sup>

In a comprehensive study of China's use of coercive economic diplomacy, Christina Lai observes that China's imposition of economic sanctions is a means to achieve short-term political objectives.<sup>17</sup> She argues that the covert use of economic sanctions by the Chinese government is tied to their self-proclaimed ‘peaceful rise’ in the region, and it therefore poses a curious challenge to scholars due to Beijing's consistent denial of ever imposing such sanctions in the first place.<sup>18</sup> This denial, Lai notes, may jeopardize China's image as a peaceful ‘riser’ in the region due to its inconsistent and unpredictable nature. The fact that China relies on strategic denial of action while evidently imposing some forms of economic sanctions may lean against the self-perceived peaceful rise of the nation as perpetuated during the tenure of Deng Xiaoping. This observation is supported by Lai, who notes that the Chinese reliance on denial while still imposing sanctions covertly may actually jeopardize the surrounding states' perception of the so-called ‘peaceful’ rise of China as it raises questions with regards to the predictability with which they can count on Chinese economic retaliation in future disputes.<sup>19</sup> Following the nuclear tests by the DPRK in 2003 and 2006, China cut off oil supplies briefly yet refused to comment on the matter. In 2011, they cut off oil supplies again following the shelling of South Korean navy ship, the Cheonan, under the guise that the cut-off was due to technical error. They, yet again, refused to acknowledge the linkage.<sup>20</sup> Lai believes that this particular refusal to acknowledge measures taken against North Korea may actually represent a strategic calculation in terms of national interests combined with a concern for international reputation. She notes that if China ever fails to actually rebuke North Korea through overt economic sanctions or leverage, China may fear the risk of being put in a rather embarrassing position in the face of North Korean provocations.<sup>21</sup>

Chinese export restrictions on rare earth materials against Japan following the arrest of a Chinese fishing boat captain in 2010 were justified as a means of environmental protection as well as human and plant safety. As the US, the EU, and Japan took the case to the WTO, China may have managed to put pressure on Japan, as the captain *did* get released, but they also arguably lost face greatly in

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16 Christina Lai, “Acting one way and talking another: China's coercive economic diplomacy in East Asia and beyond,” *The Pacific Review* 31, no. 2 (2018): 170.

17 *Ibid.*, 174.

18 Lai, “Acting one way and talking another,” 171-172.

19 *Ibid.*, 173.

20 *Ibid.*, 176.

21 *Ibid.*, 177.



the international community.<sup>22</sup>

In 2011, China imposed serious restrictions on the import of salmon from Norway, and until recent normalization of relations in 2017, these restrictions had serious effects on Norway's salmon exports, resulting in an observable 60% decrease in 2011.<sup>23</sup> Before imposing sanctions, China had warned the Nobel committee that awarding Chinese dissident Liu Xiaobo would have serious consequences for bilateral relations and even pressured other nations into boycotting the ceremony in Oslo — all this despite the fact that the Nobel Prize Committee is independent from the Norwegian government. China publicly stated that any country's choice to attend such a ceremony, challenging the Chinese judicial system, would have to bear the consequences of such actions.<sup>24</sup>

The following year, following increased tension between China and the Philippines in the South China Sea, China imposed restrictions on the import of Philippines bananas, claiming that pests had been found in its banana imports — a sudden first of its kind. Simultaneously, a large Chinese travel agency suspended all trips to the Philippines under the guise of safety concerns. Lai observes that while no concrete statements were made by the Chinese government at the time, officials' statements hinted at the possibility of import bans being related to disputes in the South China Sea, noting that if the situation kept deteriorating, it could have serious consequences for bilateral ties, trade included.<sup>25</sup>

Thus, China has, on several occasions, utilized economic sanctions in situations where it did not view military force as a viable, cost-effective option. According to Baldwin's logic, this is not necessarily because the Chinese government believed that economic sanctions would be an effective deterrent or means of pressure (though it did result in the eventual release of the fishing boat captain by Japan). Rather, the repeated use of economic sanctions has been the more cost-effective choice for the regime when they wanted to punish other states for their actions, whether they be political or not in nature and whether they directly related to foreign policy measures or not.

If one considers this explanation as well as Lai's observations that China may be utilizing these sanctions and denial of such strategy as a means of protecting their regional reputation as a peaceful riser and have been doing so over the past 15 years; Lai's observation that China's impositions of these sanctions, and subsequent denial, may compromise the surrounding neighbor's perception of China's consistency becomes less persuasive. This is mainly because her assertion that China's "pretense" affects her neighbor's perception of her as predictable appears to hinge on surrounding neighbors' assumed 'resetting' of their expectations

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22 Ibid. 178.

23 Bonni S. Glaser, "China's Coercive Economic Diplomacy: A New and Worrying Trend," *Center for Strategic International Studies*, August 6, 2012, accessed Dec. 10, 2018, <https://www.csis.org/analysis/chinas-coercive-economic-diplomacy-new-and-worrying-trend>.

24 Lai, "Acting one way and talking another," 182.

25 Ibid., 179.

of China, which is hardly a plausible assumption in international politics.

It is highly unlikely that other states, in their dealings with China, do not consider China's history of foreign policy behavior at all and thus do not learn from past experiences. Thus, the surrounding countries, having witnessed such behavior from China over almost 2 decades, ought to have come to the realization that economic sanctions are a viable tool in China's arsenal of statecraft, and that they can expect China to use it in situations where military action would not be cost-effective, but where China obviously would still wish to at least punish their political behavior. The argument that China's behavior ought to make her neighbor's uneasy based on her repeated use of economic sanctions is therefore not persuasive. While the notion of a peaceful rise may be questioned in the process, China's neighbors are likely to consider the probability of economic sanctions being imposed, when weighing their foreign policy options. Thus, while China denies its use of economic sanctions, it has a long history of imposing them. However, in China's view sanctions are not necessarily imposed to make the target state change its mind; rather, they are means of punishing target states for their political decisions in a cost-effective manner.

### The THAAD Issue

The US hinted at the possibility of THAAD being deployed already in 2014, with official statements by the US commander of forces in South Korea admitting to having recommended the deployment of THAAD in South Korea to the US government.<sup>26</sup> South Korea, however, was hesitant and expressed clear preferences to developing its own original Korean defense system over joining a US-led BMD system.

Following the fourth nuclear test by North Korea in early 2016, however, this stance took an abrupt turn. While no official agreement had been reached at the time, the confirmation of such undertaking came a month later, when the US and South Korea announced that they were in the planning stages of possibly deploying the THAAD defense system on South Korean territory.<sup>27</sup> This announcement came following a direct ROK presidential attempt at including China in the process, calling on Chinese President Xi Jinping and his administration to actively cooperate with South Korea on finding a productive solution to the North Korean nuclear problem.<sup>28</sup> With the Korean government under intense pressure from the political scandals of the Park Geun-hye administration lurking in the background, the THAAD deployment

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26 Ju-min Park, "U.S. troop leader in South Korea wants deployment of new missile defense against North," *Reuters*, June 3, 2014, accessed Dec. 15, 2018, <https://www.reuters.com/article/us-usa-southkorea-missile/u-s-troop-leader-in-south-korea-wants-deployment-of-new-missile-defense-against-north-idUSKBN0EE09120140603>.

27 United States Forces Korea statement, February 7, 2016, accessed Dec. 15, 2018, <http://www.usfk.mil/Media/News/Article/651588/rok-us-joint-announcement/>.

28 Koike, Osamu, "Deployment of the THAAD System to South Korea – Background and Issues," *NIDS Commentary* 58 (2017): 2.

was finally made official in July of 2016.<sup>29</sup> The Moon administration, however, taking office in May that following year, suspended the deployment of the THAAD system after it had been declared operational in April. While Moon's administration was steadfast in their assertion that the suspension was to give due time to following proper protocol (more specifically a legal requirement to properly assess environment effects of the area) in light of recent political scandals and accusations of corruption, some speculate that the suspension was given as concession to China and as an illustration of a less hostile stance against North Korea. However, following a series of missile tests by the North, Moon was forced to take action and called his National Security Council into meeting.<sup>30</sup> Moon accelerated the finalization of THAAD following North Korea's nuclear test in early September that same year despite his initial opposition to the system in the first place. Since the initial announcement of the deployment in early 2016, and especially since the finalization of the THAAD deployment in early 2017, Sino-ROK relations have been increasingly chillier.

### China's View on THAAD

It is hardly surprising that China expressed serious concerns regarding the deployment of THAAD in South Korea. Vice Foreign Minister Zhang Yesui expressed this clearly in a statement issued on July 8, 2016, shortly after the confirmation of the THAAD system's deployment in South Korea had been announced by the ROK-US alliance. The Ministry of Foreign Affairs' statement reads: "China firmly opposes to this and strongly urges the US and the ROK to stop relevant courses. China's will and ability to safeguard its strategic security interests are beyond doubt."<sup>31</sup> This was repeated three days later by Foreign Ministry spokesperson Lu Kang, who commented at a press conference, when asked about regional protests in South Korea regarding the THAAD deployment: "China is strongly opposed to the decision because it in particular severely undermines China's strategic security interests. We strongly ask the US and the ROK to change course."<sup>32</sup> Chinese opposition to the deployment of the THAAD system was also reiterated by Chinese head of state Xi Jinping when he met with President Barack Obama on September 3, 2016, for the

29 United States Forces Korea statement, July 8, 2016, accessed Dec. 15, 2018, <http://www.usfk.mil/Media/Press-Releases/Article/831166/rok-us-alliance-agrees-to-deploy-thaad/>.

30 Motoko Rich, "North Korea Fires More Missiles as Seoul Puts Off U.S. Defense System," *The New York Times*, June 7, 2017, accessed Dec. 15, 2018, <https://www.nytimes.com/2017/06/07/world/asia/south-korea-thaad-missile-defense-us.html>.

31 Ministry of Foreign Affairs of the Republic of China statement, "Vice Foreign Minister Zhang Yesui Summons US and ROK Ambassadors to China and Lodges Solemn Representations on the Two Countries' Decision to Deploy THAAD Missile Defense System in ROK," July 8, 2016, accessed December 15, 2018, [https://www.fmprc.gov.cn/mfa\\_eng/wjb\\_663304/zygy\\_663314/gyhd\\_663338/t1379343.shtml](https://www.fmprc.gov.cn/mfa_eng/wjb_663304/zygy_663314/gyhd_663338/t1379343.shtml).

32 Ministry of Foreign Affairs of the Republic of China statement, "Foreign Ministry Spokesperson Lu Kang's Regular Press Conference on July 11, 2016," July 11, 2016, accessed December 15, 2018. [https://www.fmprc.gov.cn/mfa\\_eng/xwfw\\_665399/s2510\\_665401/t1379216.shtml](https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/t1379216.shtml).



G20 Huangzhou Summit.<sup>33</sup> Since the announcement of the THAAD deployment by the ROK-US alliance, China has consistently opposed its installment and has not hesitated to make its stance very clear at every opportunity given. In fact, most Ministry of Foreign Affairs regular press conferences and speeches made by relevant spokespersons of the ministry have, without fail, mentioned the Chinese stance against THAAD.<sup>34</sup>

Chinese concerns are mainly rooted in the THAAD radar's ability to (at forward based mode) gain a horizontal view that spans across up to 3,000 km. They see the deployment of THAAD as a US guise to contain China's rise in the region and undermine its second strike capabilities, by installing safety measures that are ultimately aimed at spying on Chinese (and North Korean) territory.<sup>35</sup> More importantly, China sees South Korea's sudden turn to US-driven security initiatives as a form of betrayal. This notion is highly supported by Liu Tiancong in her article "ROK Factor for the Deployment of THAAD." She takes the alleged 'betrayal' by South Korea against China almost personally, and writes that as soon as South Korea saw North Korea nuclear issues becoming more complicated, they turned their back against China and fell into the arms of the US, embracing THAAD, and in the process neglected not only the relationship between China and the ROK, which had taken "decades" to develop, but also Chinese feelings in general on the matter.<sup>36</sup> Tiancong firmly asserts that the deployment of THAAD was something South Korea actively worked towards and that it was not a matter of South Korea passively being forced to accept US initiatives. She blames the conservative nature of the Korean government and even attributes its alleged hostility towards China to Park Geun-hye's personal upbringing in a military family surrounded by conservative individuals as a contributing factor to the swift deployment of THAAD, conveniently ignoring the aforementioned ROK attempts at getting China actively involved in solving the issue.<sup>37</sup> In fact, Tiancong claims that Park's use of the "Three No's" (no request, no consultation and no decision) was nothing but propaganda as well as a tool to crudely dismiss Chinese concerns for the deployment.<sup>38</sup> As Swaine puts it, "by accepting the THAAD system, a friendly Seoul had joined a growing U.S.-led anti-

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33 Ministry of Foreign Affairs of the Republic of China statement, "Xi Jinping Meets with President Barack Obama of US," September 3, 2016, accessed December 15, 2018, [https://www.fmprc.gov.cn/mfa\\_eng/wjb\\_663304/zzjg\\_663340/bmdyzs\\_664814/xwlb\\_664816/t1395073.shtml](https://www.fmprc.gov.cn/mfa_eng/wjb_663304/zzjg_663340/bmdyzs_664814/xwlb_664816/t1395073.shtml)

34 These statements have been consistently made over a long period since the first discussions regarding THAAD were made in 2014, and up until now, in 2018. Spokespersons Lu Kang, Geng Shuang and Hua Chunying have all in one way or other expressed the "consistent and firm stance of China." List of conferences: [https://www.fmprc.gov.cn/mfa\\_eng/xwfw\\_665399/s2510\\_665401/2511\\_665403/default.shtml](https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2511_665403/default.shtml)

35 Michael D. Swaine, "China's Reaction to THAAD," *China Leadership Monitor*, 53 (2017): 9.

36 Liu Tiancong, "ROK Factor for the Deployment of THAAD," *Contemporary International Relations* 27, no. 3 (2017): 31.

37 *Ibid.*, 26-28.

38 *Ibid.*, 28.

China security network in Asia centered on an invigorated U.S.-Japan alliance.”<sup>39</sup>

In addition to the fear of US alliances tightening in the region and the radar compromising Chinese security interests, China also believes that the THAAD system may spark arms races due to its excessive capabilities relative to the North Korean nuclear issue, rather than ensuring the security of South Korea.<sup>40</sup> In response to Chinese concerns, the US has asserted that the THAAD system would be locked in ‘*terminal mode*,’ assuring China that this mode has a significantly shorter range (of 600-800km) than forward based mode (which has a range of 2,000-3,000km), and thus would not have substantial coverage of Chinese territory unless said territory was close to the North Korean border.<sup>41</sup>

On February 26th, 2016, before the confirmation of the deployment, Foreign Minister Wang Yi had said: “It’s up to the ROK government to make a final decision. We of course will not interfere with ROK’s internal affair. *We understand that under such a complex environment, the United States and the Republic of Korea have an urgent need to ensure their own security* [...] when the US and the ROK discuss the deployment of THAAD, China’s legitimate security concerns must be taken into consideration, and a credible and convincing explanation must be provided to China.”<sup>42</sup> This viewpoint, however, quite clearly changed rapidly following the announcement in July, and as such, China has since been furious with the South’s decision. At a press conference on September 7, 2017, the Ministry of Foreign Affairs spokesperson Geng Shuang reiterated the Chinese stance against THAAD: “We again urge the US and the ROK to value the security interests and concerns of China and other regional countries and immediately stop the relevant deployment and remove the relevant equipment. The Chinese side has lodged stern representations with the ROK regarding this issue.”<sup>43</sup> These statements show consistent disdain for THAAD and emphasize Chinese concerns for their national security and interests overall as key factors that oppose them to its installation on the Korean peninsula.

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39 Swaine, “China’s Reaction to THAAD,” 9.

40 Robert C. Watts, “ROCKETS’ RED GLARE – Why Does China Oppose THAAD in South Korea, and What Does It Mean for U.S. Policy?,” *Naval War College Review* 71, no. 2 (2018): 85-113.

41 Ian E. Rinehart, Steven A. Hildreth, and Susan V. Lawrence, “Ballistic Missile Defense in the Asia-Pacific Region: Cooperation and Opposition,” *Congressional Research Service*, April 3, 2015, 12.

42 Ministry of Foreign Affairs of the Republic of China, “A Changing China and Its Diplomacy - Speech by Foreign Minister Wang Yi At Center for Strategic and International Studies,” February 26, 2016, accessed December 15, 2018, [https://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/zyjh\\_665391/t1345211.shtml](https://www.fmprc.gov.cn/mfa_eng/wjdt_665385/zyjh_665391/t1345211.shtml).

43 Ministry of Foreign Affairs of the Republic of China statement, “Foreign Ministry Spokesperson Geng Shuang’s Regular Press Conference on September 7, 2017,” September 7, 2017, accessed December 15, 2018, [https://www.fmprc.gov.cn/mfa\\_eng/xwfw\\_665399/s2510\\_665401/2511\\_665403/t1490884.shtml](https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2511_665403/t1490884.shtml).

### Sanctions Following THAAD

Other than acknowledging that ROK's decision to deploy the THAAD system would have adverse effects on trade relations, China has not expressed any outright intentions to impose sanctions or to retaliate against South Korea. When asked whether the deployment of THAAD would have any effect on Sino-ROK trade or economic relations, Gao Feng, spokesperson of the Ministry of Commerce of the People's Republic of China, said that "deployment of THAAD in Korea seriously injured China's strategic security interest, hurt the friendly sentiments of Chinese people, and therefore will inevitably have adverse effect on the healthy development of bilateral economic cooperation."<sup>44</sup> However, no overt statements have been made that hinted at China deliberately blocking certain Korean industries or companies from doing business in China - not from the Ministry of Commerce, the Ministry of Foreign Affairs, nor from the higher officials in government. This follows the aforementioned pattern of the absence of overt threats and of direct acknowledgment of any measures taken. China has consistently adhered to the method of encouraging the ROK to back out of the deal and condemnation of the deployment of THAAD in general.

The first signs of boycotts came in the form of an unofficial ban of Korean popular culture products in Chinese media. This included banning Korean dramas, movies and advertisements featuring Korean idols. On August 1, 2016, News1 reported that restrictions had been imposed on the activities of Korean celebrities in China due to "international factors." The restrictions were also expected to affect Korean models working in China, though overall commentators did not expect it to be a long-term policy.<sup>45</sup> In extension, the Chinese government made it suspiciously difficult for Korean acts to gain work permits in China, leading to the postponement or outright cancellation of planned fan meetings, concerts, and promotions in China. According to the New York Times, however, the Chinese government had faxed a response to their inquiry regarding visas being revoked: "China attaches great importance to facilitating the personnel exchanges between China and South Korea, and will continue to provide convenience for South Korean nationals visiting China."<sup>46</sup> A feigning of ignorance as in this response, or simply no reply at all, appear to be the go-to Chinese approach when being confronted with regards to their covert sanctions.

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44 Ministry of Commerce People's Republic of China, "Regular Press Conference of the Ministry of Commerce, September 14, 2017," September 15, 2017, accessed December 15, 2018, <http://english.mofcom.gov.cn/article/newsrelease/press/201710/20171002655990.shtml>.

45 Eunji Jeong, "China: The restriction on Korean celebrities' activities in China become reality - Tensions over THAAD deployment," *NEWS1*, August 1, 2016, accessed December 15, 2018, <https://news.v.daum.net/v/20160801105212772> (Orig. Korean).

46 Amy Qin and Sang-Hun Choe, "South Korean Missile Defense Deal Appears to Sour China's Taste for K-pop," *The New York Times*, August 7, 2016, accessed December 15, 2018, [https://www.nytimes.com/2016/08/08/world/asia/china-korea-thaad.html?\\_r=0](https://www.nytimes.com/2016/08/08/world/asia/china-korea-thaad.html?_r=0).

Another victim of seeming Chinese retaliation was Korean conglomerate giant Lotte, whose department store branch in China lost a total of over US\$160 million between 2016-2018 alone, while Lotte Mart (its grocery store branch) lost over US\$225 million according to a 2017 financial report.<sup>47</sup> Following the announcement that Lotte was in talks with the Korean government to turn over a plot of land for the deployment of the THAAD system, a Xinhua article concluded that “one misjudged step could have severe consequences,” warning that handing over the land for THAAD-purposes would result in Lotte hurting the Chinese people, and consequences would be “severe.”<sup>48</sup> According to Quartz, since signing over the land Lotte faced a \$6,400 fine for the use of exaggerated advertisements, they have had machinery confiscated and been fined another \$3,000, had partners pull out of long-standing deals and been forced to halt construction of a massive real-estate project in Shenyang, due to a fire inspection.<sup>49</sup> On March 2, 2017, when asked about potential retaliation against Lotte by the press, a spokesperson for the Ministry of Commerce said, “As for Lotte Group, I’ve noted the sentiments aired by Chinese netizens and would like to emphasize that the Chinese government sees its commercial cooperation with South Korea as important and welcomes Korean companies, among other foreign businesses, to invest and grow in China. China will, as always, protect the legitimate interests of foreign companies in China on condition that the operations of related companies in China are law-abiding and compliant.”<sup>50</sup> Not surprisingly, the Ministry of Commerce leaped elegantly over the option to admit any retaliation and emphasized that law-abiding companies are always welcome, insinuating that Lotte is being punished because it broke the law, not because of biased retaliation by official institutions in China.

Finally, a large blow to the Korean economy came in the form of Chinese bans on group tours to South Korea. As a pattern of retaliation began to emerge against Lotte, Yonhap News reported simultaneously that the Chinese government had instructed travel agencies to stop selling trips to South Korea.<sup>51</sup> These bans apparently targeting the enormous Chinese tourist flow to South Korea entailed the suspension of all travel packages online and offline. According to Yonhap’s sources, the orders

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47 “South Korea’s Lotte seeks to exit China after investing \$9.6 billion, as THAAD fallout ensues.” *The Strait Times*, March 13, 2019, accessed May 1, 2019, <https://www.straitstimes.com/asia/east-asia/south-koreas-lotte-seeks-to-exit-china-after-investing-96-billion>.

48 Gu Liping (ed.), “Lotte should avoid playing with fire in letting THAAD in,” *Xinhua*, February 20, 2017, accessed December 15, 2018, [www.ecns.cn/voices/2017/02-20/245993.shtml](http://www.ecns.cn/voices/2017/02-20/245993.shtml).

49 Echo Huang, “The maker of Choco Pies is facing a revolt in China from customers, partners, and hackers” *QUARTZ*, March 3, 2017, accessed December 15, 2018, <https://qz.com/922792/choco-pie-maker-lotte-group-is-facing-a-revolt-in-china-from-customers-partners-and-hackers-over-a-deal-involving-the-thaad-antimissile-systems/>.

50 Ministry of Commerce of the People’s Republic of China, “Regular Press Conference of the Ministry of Commerce, March 2, 2017,” March 4, 2017, accessed December 15, 2018, <http://english.mofcom.gov.cn/article/newsrelease/press/201703/20170302529366.shtml>.

51 “China bans trip sales to Korea.” *Yonhap News Agency*. March 2, 2017, accessed December 15, 2018, <https://en.yna.co.kr/view/AEN20170302012700320>.

had been verbally transmitted by the China National Tourism Administration. While the ban was eased in late November, it was restored following President Moon's visit to Beijing in late December 2017.<sup>52</sup> When asked about the slight ease of the ban at a press conference on November 28, Foreign Ministry spokesperson Geng Shuang replied, "I'm not aware of the information you mentioned. China remains positive and open towards exchange and cooperation in various fields with the ROK. We hope the ROK will work with China to create sound conditions for exchange and cooperation."<sup>53</sup> Following the reinstatement of the group travel ban, the Chinese government and its ministries have refused to comment on the matter.<sup>54</sup>

In the above 3 instances, it is not difficult to identify and confirm the pattern observed by Lai. Quite evidently, China is utilizing its leverage as an East Asian economic powerhouse to punish its neighbors in various economic ways, and it is doing it in a poorly coveted way, with the only inconspicuous aspect of its sanctions being Chinese officials' relentless denial of such actions taking place. China manages to not only enforce economic sanctions and punish targeted nations economically, but also, to put it frankly, to irritate them by feigning ignorance or simply refusing to respond to any inquiries regarding their actions. China keeps its hands clean by never confirming any sanctions and by giving vague responses, making it difficult for the affected to actually do anything to confront the issue directly.

### Case Study: SM Entertainment

With the first industry targeted by the Chinese government being the Korean entertainment industry, it seemed only appropriate to choose a case study that resides in that particular sector of the economy. The impact that Chinese economic sanctions had on the Korean pop culture industry has been quite impressive, and as such, this paper presents and analyzes the case of top tier pop culture content producer, SM Entertainment (henceforth referred to as SM Ent.). SM Ent. is heralded one of the top 3 entertainment agencies in South Korea. It was founded by Sooman Lee in 1995 and has since produced widely popular Korean pop acts such as Girls Generation, Super Junior, SHINee, DBSK, BoA, Red Velvet and EXO. Since its founding, it has expanded and invested heavily into surrounding markets in both

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52 Cheang Ming, "China does another policy U-turn and THAAD-linked South Korean stocks aren't taking it well," *CNBC*, December 20, 2017, accessed December 15, 2018, <https://www.cnbc.com/2017/12/20/china-south-korea-thaad-linked-stocks-slide-on-tour-group-ban.html>.

53 Ministry of Foreign Affairs of the People's Republic of China, "Foreign Ministry Spokesperson Geng Shuang's Regular Press Conference on November 28, 2017," accessed December 2018, [https://www.fmprc.gov.cn/mfa\\_eng/xwfw\\_665399/s2510\\_665401/2511\\_665403/t1514728.shtml](https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2511_665403/t1514728.shtml).

54 Reuters, "South Korean inbound travel agency says China bans group tours to South." *Channel NewsAsia*, December 20, 2017, accessed December 15, 2018, <https://www.channel-newsasia.com/news/asia/south-korean-inbound-travel-agency-says-china-bans-group-tours-to-south-9512390>.



China and Japan, and it holds annual auditions all over the world to scout for new talents for its artist pool. This section accounts for SM Ent.'s marketing strategies and overt intentions to expand into the Chinese market from late 2013 as well as tracks these ambitions into the post-THAAD period to observe and analyze the more direct impact of THAAD on SM Ent.'s activities in Mainland China as well as how SM Ent.'s focus has subsequently shifted to the Japanese market instead.

### **SM Entertainment Before the THAAD crisis (2013-2015/16)**

In a financial statement from November 2013, SM Ent. revealed plans to expand into the Chinese market and focus numerous activities in Mainland China. By looking into establishing joint ventures with local companies, SM Ent. expected 2014 to bring prosperity from the Chinese market. More specifically, it aimed for a broad presence in broadcasting, including advertising and commercials, dramas and movies.<sup>55</sup> Since the debut of two-unit boy group, EXO, in 2012, SM Ent. made their goals to take over the Chinese market quite evident. The two-unit group consisted of 12 members, six of which were dedicated to EXO-K, set to promote in Korea, and six members dedicated to EXO-M, of which 4 were Chinese, set to promote in China. In 2013, 25 percent of SM Ent.'s album sales came from EXO, constituting about 1.2 million albums, illustrative of the positive feedback EXO received from fans. According to another report, dated April 21, 2014, EXO were scheduled to hold 15 concerts in China from June and beyond, accommodating 10,000 people per show.<sup>56</sup> The Beijing SM Town concert in October 2013 drew over 70,000 audiences, and the report expressed optimism with regards to China's role in its growth over the following decade.<sup>57</sup> A financial report from late 2014, however, reflected the troubles of the company; two members had left the Chinese unit of EXO, a girl group member had been involved in a scandal, Japanese earnings had been poor due to yen depreciation, and the company had received a significant tax fine. As such, the company saw a delay in its further expansion into China. A May 2015 report served positive predictions with regards to the Chinese market, as overall revenue in China rose from 9.4 percent in 2013 to 16.1 percent in the first quarter of 2015. SM China came about in 2016 in the form of subsidiary Dream Maker gaining a business license from the Chinese government and establishing two branches in Shanghai and Beijing.<sup>58</sup> With these branches, SM Ent. had great plans to debut NCT China, a boy group intended to promote in China, and this group was expected to debut in early 2016, taking advantage of the positive responses SM's artists had received in China in previous terms.

Overall, SM Entertainment showed clear intentions of wanting to expand into

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55 KBD Daewoo Securities report, SM Entertainment (041510 KQ), November 14, 2013, 1.  
56 KBD Daewoo Securities report, SM Entertainment (041510 KQ/Buy), April 21, 2014.  
57 KBD Daewoo Securities report, SM Entertainment (041510 KQ), November 14, 2013.  
58 KBD Daewoo Securities report, SM Entertainment (041510 KQ), November 14, 2016.

a growing Chinese market, as they were experiencing not just increased revenues due to increased exposure but also through actively seeking out business partners and establishing local branches in China.

### SM Strategies Post-THAAD (2016-)

While the aforementioned reports reflect a positive outlook on the future for SM Entertainment in China, the deployment of THAAD undeniably brought with it a bit of turmoil. In emphasizing the potential for a resumption of business, a report from November 2017 affirms suspicions that SM's Chinese endeavors indeed suffered as it notes "growing expectations [...] for the *likely resumption* of Chinese business."<sup>59</sup> This indicates business must have been thriving or at the very least somewhat satisfactory before the THAAD crisis. Furthermore, the same report acknowledges economic losses due to delayed exports as well as delays in licensing of the company's dramas to China. The statement directly notes "*thawing Sino- Korean relations are raising expectations for exports to China, limiting China risks*," and thus references the direct influence of foreign policy on its conduct of business in the Chinese market.<sup>60</sup> The two 2017 reports (from October 11<sup>th</sup> and November 15<sup>th</sup>) are the first to reflect a deliberate shift away from China's market. Before these two reports, one report from 2013, two from 2014, four from 2015 and three from 2016 all reflect a keen interest in committing to the Chinese market, and all include detailed plans to do so.

With the 2017 October report, however, results from the Japanese market are more prevalent in analyses, and these two reports leave out results from China altogether.<sup>61</sup> This abrupt change in market focus is further reflected in the suspension of concerts by SM artists following the restrictions by the Chinese government.<sup>62</sup> According to some sources, the bans on Hallyu content began in October 2016 and included the ban of contents funded by Korean companies as well as Korean artists appearing on TV being blurred out.<sup>63</sup>

According to APPENDIX II, the significant difference between activities in Japan vis-à-vis activities in China throughout 2016-2017 is remarkable. The pivot to the Chinese market as relentlessly promoted in the previous financial statements dating back to 2013 is hardly anywhere to be seen in their tour schedules. Out of 48 shows in 2016, only five were held in China, despite SM's reports clearly indicating

59 KBD Daewoo Securities report, SM Entertainment (041510 KQ), November 15, 2017.

60 KBD Daewoo Securities report. SM Entertainment (041510 KQ).

61 See Appendix I.

62 "EXO's China concert postponed amid row over THAAD," *Yonhap News Agency*, December 7, 2016. Online. Accessed December 15, 2018. <https://en.yna.co.kr/view/AEN20161207005900315>

63 Daniel Sanchez, "China Bans All Korean Music and Entertainment," *Digital Music News*, November 29, 2016, accessed December 15, 2018, <https://www.digitalmusicnews.com/2016/11/29/china-bans-korean-hallyu-kpop/>.

that they would be betting on the Chinese market for 2016, and these shows were all held before the ban was imposed in October. Where EXO was supposed to hold a concert in Nanjing on December 10, 2016, there were instead three consecutive shows in Japan from December 9-11. Furthermore, there has been no shows scheduled in China in 2017 and only recently have events been listed for 2018. In contrast, the Japanese tour schedules have been packed for many SM artists such as SHINee, Super Junior, their solo artists and sub-units, and for EXO. Only one show for EXO has been scheduled for 2018 in Macao so far. Finally, NCT China, reported to be set for debut in 2016 directly into the Chinese market only to be pushed back to the summer of 2018, was finally scheduled this year to debut in November. While China and South Korea have agreed to normalize relations, there has been no news regarding the group's debut in China since October this year. As such, it appears not only that SM suffered quite tremendously due to THAAD, but it also appears that they are slightly hesitant to actually commit NCT China to the Chinese market just yet, despite several news articles confirming that China has loosened its grip on Hallyu and is ready to resume business with South Korea as usual.

From this data, it is remarkably evident that the THAAD issue and the following cooling relations between China and South Korea had severe effects on the market and on SM Entertainment in particular. According to Hyundai Research Institute, South Korea's Hallyu industry lost nearly \$7.5 billion in 2017 alone, equivalent to approx. 0.5 percent of the country's nominal GDP.<sup>64</sup> As such, China has most definitely illustrated its ability to teach South Korea a lesson, and with that, it has succeeded in severely punishing South Korea for the deployment of THAAD without recognizing such measures at all. This ability appears to have left its mark, as SM Ent. is still hesitant to commit NCT China to the market and appears to be holding back any announcements of a Chinese debut as of yet.

## Conclusion

As Baldwin defines economic sanctions quite broadly, China's "covert" sanctions on its neighbors adhere to his conceptualization of economic statecraft quite appropriately. Following the deployment of the THAAD system to South Korean territory, China made it very clear that it was unhappy with South Korea's decision, and despite various attempts at encouraging the ROK to change its mind, China was unsuccessful. Thus began two long years of economic sanctions, though these sanctions were never publicly warned or threatened, but, on the contrary, were quite often outright denied by spokespersons of the Chinese regime. While the giant corporation, Lotte, took its personal hits and tourism experienced serious cuts

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64 "THAAD may lead to \$7.5b economic loss in 2017: South Korean media," *CHINADAILY*, updated September 20, 2017, accessed December 16, 2018, [www.chinadaily.com.cn/world/2017-09/20/content\\_32245052.htm](http://www.chinadaily.com.cn/world/2017-09/20/content_32245052.htm).

in group travels, SM Entertainment – and the Hallyu industry overall – perhaps took the hardest punch from the conflict. Artists were denied visas, shows were cancelled, idols were blurred out on national TV in China and contents were outright banned from being broadcast. On top of that, licenses were withheld, and dramas were blocked.

The case study of SM Entertainment has shown that while SM had actually planned for almost 3 years to extend its Hallyu business into China, wanting to invest heavily in its consumer market, plans were abruptly changed following Chinese retaliation for THAAD. SM had to redirect tours and activities overall to Japan, which is reflected not only in the financial statements from Daewoo but also in its tour schedule changes. Furthermore, the company's debut of a group to China was delayed for almost two years following the THAAD crisis.

While China has not threatened any overt actions, it has become quite the master of wielding the sword of economic sanctions, and gladly does so while feigning ignorance of its evident impact on targeted states. This paper has shown not only that China has a pattern of covert economic sanctions but also that as China is possibly aware that these sanctions do not necessarily change any target state's mind or actions; these sanctions may rather be intended to punish them for their actions. As such, China has quite successfully sanctioned Norway, Japan, the Philippines, and, most recently, South Korea. The case study of SM entertainment showed some of the more direct effects that these sanctions had on the industry, while the analysis of speeches and press conferences held by spokespersons of the Chinese government revealed a pattern of them saying one thing while doing another. While Pape may argue that Chinese sanctions were unsuccessful in that they did not make South Korea change its mind or back out of the THAAD deal with the US, Baldwin would definitely argue that if the main goal of such sanctions was to make South Korea pay for their choice, they were most definitely successful, and this study has shown more precisely how.

With this study, it has thus become evident that while China is continuously hesitant to challenge any neighbors militarily or diplomatically, they do not hesitate to punish them for their unsatisfying actions economically. The delay of NCT China and the serious lack of shows and appearances in Mainland China following THAAD have taken their toll on SM's revenues, and as relations between China and South Korea thaw, SM may still be hesitant to commit their new boy group to China, due to fears of having some members from the group banned from performing in China, should diplomatic relations take another turn for the worse.

As China continues to grow as an economic power house in the Asia-Pacific, further studies on its economic diplomatic ways – particularly on how it sanctions its neighbors and why/when – will be of great help in guiding companies caught between China and its target states. While China's tendency to deny any retaliation may constitute an annoyance to the international community, it is hardly likely to change, and China is likely to continue punishing other countries economically, as long as such endeavors continue to be utility cost-efficient. Furthermore, it is likely that while China could of course hope for a change of course in its target states' policies, it is well aware that its sanctions will not change their stances or policy

decisions, and, as such, it would be appropriate to assume that China's objectives are not to compel but rather to punish. As this study has shown, China is willing to go to great lengths to punish any target state for its choices if these do not fall within the preferences of the Chinese government.