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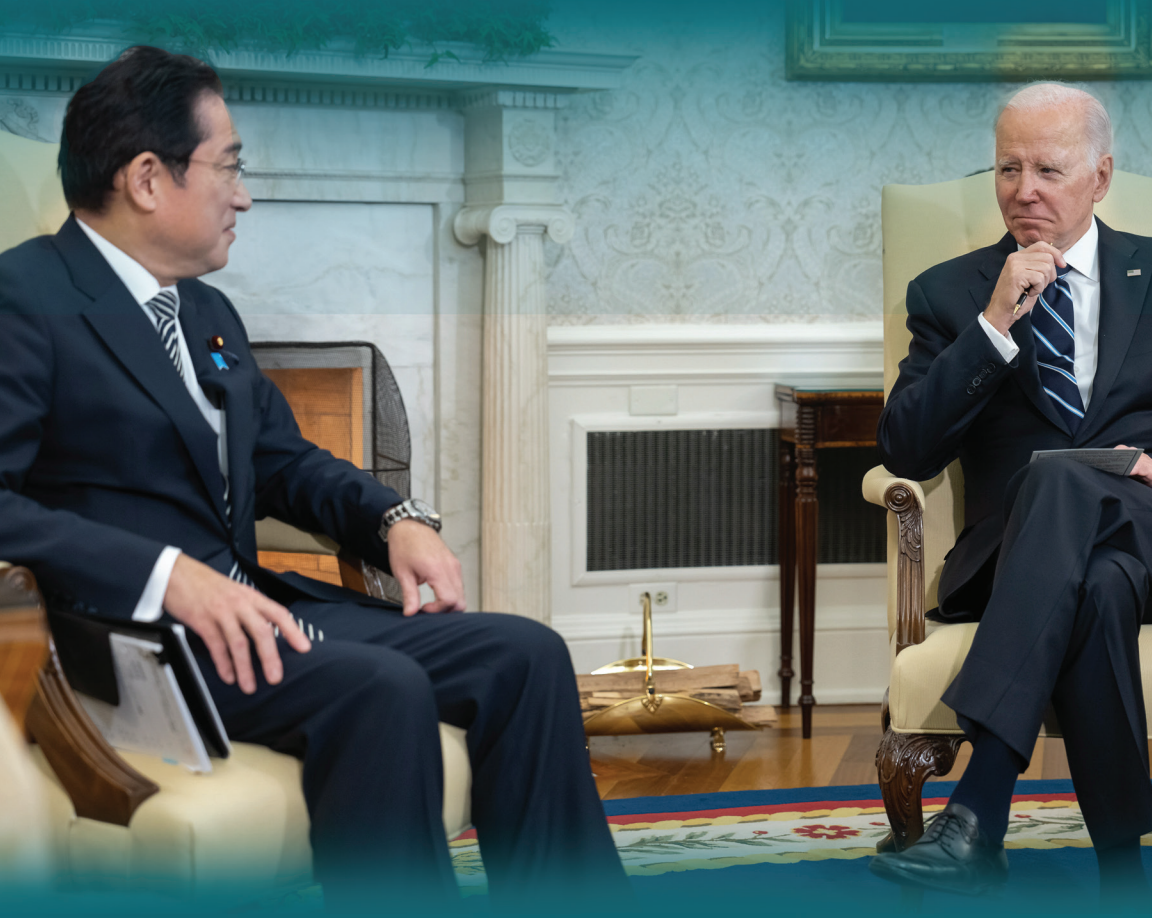


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GEOECONOMICS AND INDO-PACIFIC ENTERPRISE INITIATIVE

# Reshaping US-Japan Economic Security Partnership in the Indo-Pacific

**Essays by:** Shihoko Goto , Walter M. Hudson,  
Lucas Myers , Jun Osawa, and Yasuyuki Todo





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CHAPTER ONE

# US-Japan Economic Security Policy Implications

*Photo courtesy: Travel mania / Shutterstock*

With the emergence of economic security as a concept in recent years, the US-Japan alliance has entered what is arguably its closest era as both countries increasingly link economics and traditional hard power conceptions of national security. The United States and Japan should continue to emphasize economic security to address shared challenges in the Indo-Pacific driven by a rising China and global risks, such as pandemics and climate change.

The following section details the policy implications contained in each essay:

### **“Testing the Bond of Shared Economic Security Interests”**

Shihoko Goto and Lucas Myers

- The United States and Japan should cooperate in the development of next generation technologies. As predominantly market economies facing an increasingly state interventionist opponent, both countries should foster public-private collaboration. Additionally, the United States and Japan should identify key areas of competitive advantage and leverage the relationship to make mutually beneficial improvements.
- Following success in kickstarting the derisking process for semiconductor supply chains, the alliance’s focus should move to target derisking supply chains for critical minerals, including rare earths, cobalt, and nickel.
- Southeast Asia will be the key region for economic competition with China. Japan has historically been the partner of choice for Southeast Asian countries, while the United States remains the foremost security provider. Considering limits to US economic outreach, primarily on trade, the alliance should leverage its comparative advantages to jointly compete with China in the region.
- US and Japanese visions for economic security envision building upon and improving the post-war economic order. In the Indo-Pacific, the United States and Japan have a real opportunity to leverage their pre-existing relationships, investments, and policy initiatives to jointly engage in order building.

## **“Evolving US Economic Strategic Approaches to China”**

**Walter Hudson**

- Regardless of whether it adopts a “small yard, high fence” or an “industrial strategy” strategic approach, US economic strategy should be flexible, pragmatic, and adaptable.
- US economic strategy will reflect the vicissitudes of each institution and administration, and it may change or evolve over time depending upon political conditions and the international environment. A strategy is rarely fixed.
- The United States should be cognizant of tensions within its current narratives on US economic strategy. Movements toward a robust “industrial strategy” may strike many observers that the administration is shifting away from its promise to “return to order” toward a more nationalized and even transactional economic modality.
- The convergence of economic interest and national security concerns has not been seen for several decades in the United States. This shift in thinking will have profound implications for how US policymakers approach domestic policy, and how they develop foreign strategy with long-established allies including Japan as well as with authoritarian regimes.

## **“How Japan Defines Economic Security”**

**Jun Osawa**

- The United States and Japan are increasingly aligned on the need to compete with China in the realm of economic security. For Tokyo, this represents a seismic shift in thinking and embrace of national security considerations. Although challenges remain, both countries should rest assured that they can rely upon each other to secure their economies from China.
- The United States and Japan should strengthen cooperation in the field of cyber defense to protect our key technologies, which are the source of our national strength.



- Both countries should cooperate to protect critical infrastructure, which is the foundation of national security and economic activities, from Chinese cyberattacks.
- Washington and Tokyo should work together to reduce vulnerability to disruption of strategic goods and supply chains.

## **“Supply Chain Resilience and the Innovation Challenge”**

Yasuyuki Todo

- Economic security requires balancing national security needs and economic growth across a wide variety of governments, private sector actors, and stakeholders. Securing supply chains will require Tokyo and Washington to look both at home and abroad.
- Japan and the United States should leverage multilateral frameworks (for example, the G7, IPEF, and SCRI) to invest in friendshoring to diversify supply chains and offset dependence upon China.
- “Knowledge friendshoring” can enhance international research collaboration and accelerate the development of technologies crucial for maintaining a competitive edge.

## CHAPTER TWO

# Forward

**Mark Andrew Green**, President & CEO, Wilson Center  
Ambassador and Congressman (Ret.)  
Washington DC  
July 2023



*Photo courtesy: Official White House Photo by Lawrence Jackson*

In the wake of sweeping pandemic-driven disruptions and in the midst of rising concerns about an assertive and aggressive China, protecting economic interests from a national security perspective now occupies center stage for both US and Japanese policymakers. This report explores shared interests between the United States and Japan on economic security, assesses the potential challenges in bilateral cooperation, and offers innovative policy solutions designed to enhance the US-Japan alliance and bilateral partnership.

True friendship is based on shared values and trust. The United States and Japan are not only aligned in their views concerning the need to focus on economic security, but they are also prepared to work closely together to meet shared objectives. As a Congressionally chartered, scholarship-driven think tank, the Wilson Center is unique in its ability to offer an independent, non-partisan analysis that both navigates the shifts in geoeconomic realities and offer insights on the path forward.

This report represents the culmination of a year-long research project generously funded and supported by the US Department of State's Tokyo Embassy. We are grateful for their support throughout this project. This project would also not have been possible without our partners in Japan: the Sasakawa Peace Foundation, Waseda University, and the Nakasone Peace Institute. The report's four essays suggest ways to expand and enhance US-Japan economic security cooperation in an era that can be accurately described as the strongest of the US-Japan alliance in the past 72 years. Although some differences remain, the United States and Japan share the goal of a free, open, and prosperous Indo-Pacific, free from coercion and aggression. Working together, Tokyo and Washington's economic security cooperation will ensure this vision comes to fruition.

CHAPTER THREE

# Testing the Bond of Shared Economic Security Interests

**Shihoko Goto**, is Director for Goeconomics and Indo-Pacific Enterprise and Deputy Director for the Asia Program at the Wilson Center

**Lucas Myers**, is the Senior Associate for Southeast Asia for the Asia Program at the Wilson Center



*Photo courtesy: Official White House Photo by Adam Schultz*

## Summary:

Following pandemic-era disruptions and China's economic coercion, the United States and Japan have embraced "economic security," the merging of economics into national security. This has opened up a new era in the US-Japan alliance, expanding options for collaboration on economic issues that previously divided the two countries. Both countries rapidly identified resilient supply chains and enhancing trust as key objectives of their increasingly collaborative economic security policies.

However, some differences continue to challenge cooperation. For one, the US disfavor of trade agreements arguably hinders its ability to compete against China. Secondly, Japanese policymakers and corporations are concerned that US protectionist economic policies could harm Japanese investments in the United States. Thirdly, a disconnect on the extent of derisking from China could prove a stubborn impasse over time, with Japan remaining less willing to decouple from the Chinese market in key sectors.

Yet, the overall alliance is arguably the healthiest it has been in decades. Undergirded by mutual interests in economic security, the United States and Japan are well-positioned to expand their cooperation in the Indo-Pacific to anchor, secure, and stabilize the world's fastest growing region around a free and open economic order.

## Policy Implications:

- The United States and Japan should cooperate in the development of next generation technologies. As predominantly market economies facing an increasingly state interventionist opponent, both countries should foster public-private collaboration. Additionally, the United States and Japan should identify key areas of competitive advantage and leverage the relationship to make mutually beneficial improvements.
- Following success in kickstarting the derisking process for semiconductor supply chains, the alliance's focus should move to target derisking supply chains for critical minerals, including rare earths, cobalt, and nickel.

- Southeast Asia will be the key region for economic competition with China. Japan has historically been the partner of choice for Southeast Asian countries, while the United States remains the foremost security provider. Considering limits to US economic outreach, primarily on trade, the alliance should leverage its comparative advantages to jointly compete with China in the region.
- US and Japanese visions for economic security envision building upon and improving the post-war economic order. In the Indo-Pacific, the United States and Japan have a real opportunity to leverage their pre-existing relationships, investments, and policy initiatives to jointly engage in order building.

Since its founding in 1951, the US-Japan alliance centered on traditional conceptions of security, predominantly hard power, first against the threat of communist expansion and now in the face of modern threats stemming from a nuclearizing North Korea and a rising, assertive China. Yet, Tokyo and Washington now share a realization borne out of the disruptions of the pandemic and Chinese economic coercion that economics and national security can no longer remain separated in the policy space.

In order to ensure prosperity, hedge against looming threats, and advance a free and open Indo-Pacific, the United States and Japan will have to build upon their nascent economic security cooperation, overcome challenges posed by differing points of view, and implement a shared policy agenda that can pave the way forward for an alliance increasingly defined as much by economics as traditional conceptions of national security.

## The emergence of “economic security”

Before the outbreak of the global pandemic in 2020, trade imbalances in goods had been one of the biggest sources of friction between the United States and Japan. Amidst long-term shifts towards a service- and finance-dominated economy, prospects for U.S. manufacturing seemingly took a back seat in defining the nation’s competitiveness despite the dominance of the United States in the global economy and its role in shaping the future of advanced technologies worldwide. In its relations with Japan, it was clear that a trade deficit in goods, most notably in the automobile industry, would continue to be a long-standing thorn in defining ties between Washington and Tokyo.

Yet, seismic shifts in the international system have reinvigorated U.S.-Japan cooperation, coalesced around the concept of “economic security.” Disruptions caused by COVID-19 have led to a fundamental change in defining relations between the world’s biggest and third-largest economies. At the same time, national security concerns converge with economic interests as part of a broader effort to enhance domestic resilience. In the case of the United States, the pandemic had made clear that an over-reliance on goods produced in authoritarian regimes can actually hurt U.S. resilience, from medical products to construction supplies and information technology product components. Japan, on the other hand, was

already all too familiar with the risk of over-reliance on China. Beijing's 2010 ban on the export of rare earths in response to Tokyo nationalizing the Senkaku Islands became a defining moment in the evolution of Japan's economic relations with China.<sup>1</sup>

Economic security can be understood as the active incorporation of economics into national security policy built on the realization that domestic and foreign policy agendas are intertwined. This understanding of the merging of economics and national security presents both risks, as seen in pandemic disruptions to supply chains and Chinese efforts to deploy coercive policies against its rivals' economies, as well as rewards, most notably in jumpstarting renewed investments in domestic production of critical materials and products. For the United States in particular, economic security means a more top-down approach to the economy, which challenges Washington's long-held position on markets ultimately driving growth.

In this new era of US-Japan relations, competition over market share and advancing the interests of key industries are no longer the driving forces shaping bilateral trade relations. Instead, shared economic interest in hedging against emerging risks to steady and ensure growth fosters enhanced bilateral ties. From scrambling to secure access to critical supplies such as medical equipment in the fight against COVID-19, to obtaining technology goods in the face of manufacturing, shipment, and delivery delays, no country emerged unscathed from pandemic-era border closures and shutdowns in economic activity. Nations across the board have learned that while global integration can lead to greater efficiencies and competitiveness, resilience also requires countries to enhance their capabilities to withstand future unexpected disruptions, which remain inevitable.

Three years since the world economy effectively came to a standstill in response to the global pandemic, both Washington and Tokyo embrace a closer, more tightly coordinated economic partnership, not only by cooperating in anticipation of future disruptions, but also by advancing mutual economic security interests based on a shared commitment to the rule of law and regional stability in the Indo-Pacific. The United States and Japan are increasingly acting in concert, with both countries taking an active role in defining and developing policies and frameworks to advance shared economic interests, particularly surrounding resiliency and trust.



## Shared concerns of resilience and the value of trust

Supply chains have emerged as a core and pressing element of the economic security agenda for both the United States and Japan. Throughout the latter decades of the 20th century, multinational corporations perfected the cost effectiveness and efficiencies of supply chains driven by pursuit of lower costs, but the lack of consideration for geopolitical risk ultimately proved to be a liability during the unexpected and sustained disruptions caused by COVID-19. In particular, overdependence upon Chinese manufacturing proved catastrophic when large portions of the country shut down under its Zero Covid policy.<sup>2</sup> This contributed to serious backlogs throughout the supply chain, as well as inflation.

By June 2021, the Biden administration identified semiconductor manufacturing, large capacity batteries, critical minerals, and pharmaceuticals as the four key areas to target for supply chain resiliency.<sup>3</sup> Those four areas were also identified by Japan as critical for its own economic resilience as well.

For Washington, supply chains now lie at the forefront of US national security. As Walter M. Hudson argues in “Evolving U.S. Economic Strategic Approaches to China,” the evolution from a hands-off approach to industrial policy and economics to a comprehensive understanding of national strategy inclusive of economic security is a remarkable bipartisan shift in thinking in Washington.

Tokyo, meanwhile, also began to develop a more comprehensive strategy to deal not only with the immediate challenges of supply chain disruption, but also the longer-term concerns of domestic economic resilience and competitiveness. As Jun Osawa highlights in “How Japan Defines Economic Security,” Japan’s shift towards a more open competitiveness with China is equally significant, as is the seriousness of its efforts to practice economic security.

For Japan, economic interests play an integral part in advancing its foreign policy objectives of broader regional stability and security. One of Prime Minister Fumio Kishida’s first actions after taking office had been to appoint an economic security minister in October 2021, followed by the eventual passing of an economic security law by May 2022 in order to secure the country’s critical infrastructure, technology capabilities, and supply chains to ensure Japan’s longer-term competitiveness in the global economy.<sup>4</sup> The fact that the Diet debated national security legislation well before the national security strategy was unveiled at the

end of 2022 also signaled Japan's focus on economic security as a means to navigate geopolitical tensions and not simply to promote growth.

The dual-strategy approach of focusing simultaneously on security interests vis a vis China and advancing economic resilience is in line with Washington's own approach to economic security, most notably the CHIPS and Science Act of August 2022 that aims to provide nearly \$53 billion in semiconductor research and manufacturing within the United States alone.<sup>5</sup>

Both the CHIPS Act and Japan's economic security law have made clear not only shared concerns between Washington and Tokyo, but also their shared view of the systemic threats facing the prevailing global economic order. For instance, the inaugural ministerial meeting of the US-Japan Economic Consultative Committee meeting in July 2022 highlighted the fact that the two countries shared a commitment not only to promote growth worldwide post-COVID, but also to act as global models that ensure economic expansion that advances the middle class.<sup>6</sup>

## **Moving forward beyond identifying economic security risks**

But while defining the risks to growth and the rules-based order may have brought the United States and Japan closer together—to the extent that some have described bilateral relations as the strongest that they have ever been—defining the way forward will not be as easy.

For one, the United States' domestic dynamics have moved away from trade agreements as an element of its economic policy. However, as the United States attempts to compete alongside its allies and partners against Chinese economic dominance and influence, its inability to enter into the trade agreements emerging throughout the Indo-Pacific—most importantly, the rebranded Trans-Pacific Partnership, the Comprehensive and Progressive Trans-Pacific Partnership—hampers its outreach. Although IPEF may enable the United States to set rules and open new avenues for economic engagement, such as in the digital space, Japan and others, particularly in Southeast Asia, remain concerned that US policy in the Indo-Pacific is shallow on the economic front.

Secondly, there has been unease amongst both Japanese policymakers and corporate executives alike in more protectionist U.S. economic policies. Washington's industrial policies adopted over the past year have come under less scrutiny, given

that Japan and Europe too have adopted similar measures in bolstering the growth of their own key industries, including for semiconductors. After some initial concern over the extent of US export controls on semiconductors sold to Chinese firms, Japan and the Netherlands agreed to join in on the restrictions.<sup>7</sup>

What they have been more apprehensive about, however, are policies that could work against Japanese investments within the United States. Certainly, the Inflation Reduction Act's focus on promoting U.S. electric vehicle manufacturers at the cost of non-US brands has increased uneasiness in Tokyo,<sup>8</sup> even though Japanese public reaction to the IRA's tax credit policies have been far more muted than that of the Koreans or Europeans. It is important to remember that, although the United States and Japan agree on the fundamentals of enhancing economic security against Chinese coercion, US and Japanese companies and governments still maintain a friendly form of economic competition amongst themselves.

Another risk is the potential for Washington and Tokyo not to see eye to eye on China in defining a common stance on economic security. Currently, both countries are focused on pushing back against China leveraging its economic advantages and taking punitive action against those countries that have undermined Beijing's position. The United States and Japan are also on the same page when it comes to keeping advanced technology away from China, and prevent Beijing from abusing technologies for its own military or surveillance purposes.

But, even as Japan has faced the wrath of China and been hard hit by Beijing's economic coercion in the past, its position remains the continuation of economic ties with China. For Tokyo, decoupling had never been a viable option. Japan's preferred pragmatic approach to dealing with Beijing is to move forward with a "China Plus One" strategy by retaining existing investments in the PRC whilst promoting new investments in Southeast Asia and beyond, rather than pulling out and severing ties with China altogether. As such, the push to continue to engage with the Chinese government remains not just of economic but also of political interest for the Japanese leadership.

## **Promoting economic security interests in the Indo-Pacific: a policy agenda**

Despite the challenges, the fact remains that the US-Japan alliance enjoys a renewed commitment to forging closer relations and cooperating closely on

economic security in the face of global risks. There are a variety of policy issues that should serve as the foundations for enhanced US-Japan economic security in the Indo-Pacific, including developing critical technologies in conjunction with derisking, derisking critical mineral supply chains from China, enhancing joint outreach to Southeast Asia, and shoring up a free and open Indo-Pacific, particularly in lieu of US trade deals.

For one, that the United States and Japan have come together to protect critical technologies from falling into the hands of Chinese actors signals a strong baseline of cooperation on this issue, but more can be done, in particular in furthering joint development of next generation technologies.

There are a few areas of particular need to ensure the United States and Japan remain ahead of China. For instance, joint development of critical technologies, such as artificial intelligence and quantum communications is important. As Yasuyuki Todo argues in “Supply Chain Resilience and the Innovation Challenge,” fostering US-Japan joint efforts to develop technology, particularly via “knowledge friendshoring,” will be key. Additionally, as predominantly market economies facing an increasingly state interventionist opponent, the United States and Japan should build on the Quad’s Technology and Business Investment Forum via a bilateral version to further encourage public-private collaboration, between and across US and Japanese companies.<sup>9</sup> Closer coordination between both governments and their respective private sectors would go a long way towards bridging the gap in sensitivity towards derisking with China and protectionism.

Finally, there are areas of competitive advantage for both countries. For the United States, its efforts to boost domestic manufacturing will take time,<sup>10</sup> and could benefit from Japanese knowhow and foreign direct investment. For Tokyo, Japan arguably lags in support and infrastructure for technology startups, particularly in the university system. Japanese efforts to implement a stronger security clearance system inspired by the United States is a good example of how Tokyo can learn from Washington.<sup>11</sup> Renewed focus on technology development could also reinvigorate Japanese economic growth more broadly, and could also lead to positive social changes that would encourage risk-taking and greater diversity in the workplace.

A second challenge lies with derisking supply chains of materials at the heart of advanced technology, including politically and environmentally sensitive critical

minerals. The risk of a repeat of China's 2010 restrictions against Japan could prove dire during a confrontation over Taiwan, so reducing reliance upon Chinese critical minerals is paramount.

China dominates the mining and refining of several key minerals crucial for the future of the global economy. Chinese firms currently controls about “63 percent of the world's rare earth mining, 85 percent of rare earth processing, and 92 percent of rare earth magnet production” despite US and Japanese efforts to reduce dependence.<sup>12</sup> For Cobalt, a core component of lithium ion batteries in electronic vehicles, 41 percent of mines are Chinese-owned, 73 percent of refineries, and, ultimately, 54 percent of electronic cars are produced within China's borders.<sup>13</sup> China increasingly dominates nickel production, another crucial element of electric vehicle production.<sup>14</sup> Unilateral and joint US-Japan investments in critical minerals could serve as the crucial next step in derisking supply chains from Chinese dominance.

Third, Southeast Asia, by virtue of its geographic position at the heart of the Indo-Pacific, rapid economic growth, and position at the forefront of Chinese efforts to assert itself in the region, is perhaps the key “battleground” between Beijing, Tokyo, and Washington. Engagement with Southeast Asia extends beyond economic ties, but also cannot strengthen without significant economic commitment moving forward. As negotiations for the Indo-Pacific Economic Framework move forward, the role that Japan played in ensuring that key Southeast Asian nations including Malaysia, Indonesia, and the Philippines were willing to consider becoming IPEF members can be leveraged to ensure that the policy of derisking from China continues to be pursued.

However, while Japan leads in Southeast Asian infrastructure development and the United States in foreign direct investment, China continues to compete effectively—and make gains—in the region. At the same time, Southeast Asia is increasingly the primary target for China Plus One investments in technology manufacturing, as well as in certain critical minerals like nickel and rare earths. With the US political climate likely precluding traditional trade deals, it may be up to joint US-Japan initiatives to provide an effective counterweight to China.

Fourth and finally, both the United States and Japan view economic security as ensuring a just and prosperous order. The Indo-Pacific Economic Framework, the G7's Partnership for Global Infrastructure and Investment, the Blue Dot

Network, and other multilateral initiatives serve to establish new rules for the Indo-Pacific economic order. The US-Japan alliance should continue to cooperate closely on presenting a united front on building a just and equitable regional order that can withstand the challenges posed by China, other revisionist states, and climate change.

Ultimately, Washington and Tokyo envision a “free and open Indo-Pacific” as the end goal of their economic security strategies. However, this is not a vision for the status quo, but rather a promise to reshape economic order in a new direction. As US National Security Adviser Jake Sullivan recently said, “the last few decades revealed cracks in [the post-war international economic order’s] foundations... so this moment demands that we forge a new consensus.”<sup>15</sup> The US-Japan alliance has evolved from a hard power-first relationship to one that increasingly centers economic security as the lynchpin of their cooperation. The United States and Japan have a solid foundation for furthering their economic security partnership in preventing China from getting critical technologies, and the four policy areas outlined in this essay will pave the way for enhanced cooperation. At the same time, they must remain cognizant of occasional differences of opinion, particularly vis-a-vis China and protectionism. If Washington and Tokyo can continue to deepen their economic security cooperation in the Indo-Pacific, the world’s largest and third-largest economies will anchor, secure, and stabilize the world’s fastest growing region around a free and open economic order.

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*The views expressed are the authors’ alone, and do not represent the views of the U.S. Government or the Wilson Center.*





CHAPTER FOUR

# Evolving US Economic Strategic Approaches to China

**Walter M. Hudson**, Colonel, US Army (retired) is an associate professor at the Eisenhower School for National Security and Resource Strategy of National Defense University

*Photo courtesy: Official White House Photo by Adam Schultz*



## Summary:

The United States has embraced a strategic rethink towards economic security in an attempt to engage in geoeconomics in recent years. Largely spurred by the rise of China and a recognition that economic considerations are inextricably linked to national security concerns, US efforts to develop an economic strategy have evolved along a general trend with two variations: a “small yard, high fence” approach and “industrial strategy.”

This first approach can be characterized as developing along a strategic center of gravity called “invest/align/compete” against China and shaping international order in the favor of the United States and its allies and partners. At the same time, this strategy keeps the door open to economic interaction with China, particularly if it behaves as a responsible actor within the current order.

The second, more forward-leaning approach developed as the administration hardened its approach over time in 2022. In particular, the United States now aims to maintain an edge over China technologically, by both investing at home and preventing Chinese access to bleeding edge critical technologies. This is partially a response to the scale of the challenge posed by China and other revisionist states, notably Russia following its unjustified invasion of Ukraine. Importantly, the “industrial strategy” approach includes a greater willingness to challenge existing features of the post-war international economic order and to engage in industrial policy.

While debate continues to rage, including about “peak China,” this merging of previously siloed economic and security policy signals a new era in US strategy.

## Policy Implications:

- Regardless of whether it adopts a “small yard, high fence” or an “industrial strategy” strategic approach, US economic strategy should be flexible, pragmatic, and adaptable.
- US economic strategy will reflect the vicissitudes of each institution and administration, and it may change or evolve over time depending upon political conditions and the international environment. A strategy is rarely fixed.
- The United States should be cognizant of tensions within its current narratives

on US economic strategy. Movements toward a robust “industrial strategy” may strike many observers that the administration is shifting away from its promise to “return to order” toward a more nationalized and even transactional economic modality.

- The convergence of economic interest and national security concerns has not been seen for several decades in the United States. This shift in thinking will have profound implications for how US policymakers approach domestic policy, and how they develop foreign strategy with long-established allies including Japan as well as with authoritarian regimes.

In the spring of 2022, the Japanese Parliament passed the Economic Security Promotion Act, a comprehensive four-part economic strategy that covered a range of topics, from ensuring resilient supply chains for designated strategic resources to providing research and development funds for advanced technologies.<sup>16</sup> In contrast, the United States typically does not often or readily engage in such economic strategizing. US economic *policy*—something that sets broad parameters regarding economic issues—occurs frequently. But strategy—to include economic strategy—seeks “to create effects that protect or advance the state’s interests in the strategic environment.”<sup>17</sup> Strategy connotes something much more intentional, directed, and definite.

Indeed, any long-term economic strategy, especially focused on a peer competitor, has generally been something quite outside the range of the US experience. During the Cold War, the strategic competition with the Soviet Union was overwhelmingly militarily focused, and economic considerations would often take a back seat. That was easier too, given the limited economic interaction between the United States and the USSR at the time. Dealing with economic competition is also not as straightforward due to domestic considerations with the United States. While the US executive branch may be in the lead for a militarily and/or diplomatically dominant strategy, given the President’s commander-in-chief authority and his primacy in foreign affairs, the President’s power to control the economy is considerably limited by law and constitution. Fiscal policy is ultimately directed by Congress, and monetary policy by the independent Federal Reserve. There are inherent structural limitations to economic strategy that do not exist for the President and his administration when crafting a more militarily or diplomatically focused one.

Yet times have changed, and this may be the beginning of a new era that sees a shift in US geostrategic thinking toward a more *economically* oriented, if not dominant, strategy. Or some may even call it a “gEOeconomic” strategy.<sup>18</sup> What has come forth in the last year or so from the current US presidential administration should indeed be considered as an attempt at economic strategizing, with specific focus toward a peer competitor, China. This effort has not appeared suddenly from out of nowhere, but has emerged gradually, even keeping some concerns and themes from the previous administration.

## A Review of the Current Administration's Economic Strategic Approaches

This effort can be traced by reviewing foundational strategic documents and even more so by examining and evaluating a number of speeches by high-ranking administration officials beginning in the spring of 2022. Speeches from senior-ranking administration officials are recognizably not the best way to predict an administration's behavior. Such speeches are made with the speakers' particular agendas, and the speakers often take into account their audiences and those audiences' own agendas. Nonetheless, speeches made over time can serve not only as guideposts but as windows into an administration's positions and even its strategies.

The first glimpses of a shift toward economic strategizing occurred in the last administration: "Economic security is national security" served as an epigraph to "Pillar II: Promote American Prosperity" of the previous administration's 2017 National Security Strategy (NSS).<sup>19</sup> The current administration's 2022 NSS went even further and specifically designated China as the chief economic rival. It set forth a three-prong economic strategic approach: invest in the foundations of US strength at home; align efforts with network of allies and partners; and compete responsibly with China.<sup>20</sup> Admittedly abstract and perhaps even purposefully vague, this "invest, align, compete" outlook also highlighted possible tensions and potential sources of contention: a US-focused investment strategy could result in antagonizing allies; an effort to compete "responsibly" with China left open the question as to what such responsible competition entailed.

Secretary of State Anthony Blinken elaborated on the 2022 NSS's "invest, align, compete" approach in a May 26, 2022 speech at George Washington University. He provided examples for each of the approaches' three parts: the passage of the 2021 Infrastructure Investment Jobs Act (invest), the launching of the Indo-Pacific Economic Framework for Prosperity (IPEF) (align), and the use of stronger export controls and better cyber defenses (compete) were specifically referenced. He also announced the creation of a China House—a "department-wide integrated team that will coordinate and implement our policy across issues and regions, working with Congress as needed"—thus implying that the China House could be the strategic center of gravity in the "invest, align, compete" effort.

He also set forth what might be called a strong and even aggressive approach

regarding the administration's approach toward China. China seemed to have the intent to "reshape the international order...and move us away from the universal values that have sustained so much of the world's progress over the last 75 years." Beijing was "undermining" that international order's laws, agreements, principles, and institutions. Furthermore, the United States could not "rely on Beijing to change its trajectory." Instead, the United States had to "shape the strategic environment around Beijing to advance our vision for an open, inclusive international system." Blinken noted nonetheless that China is "integral to the global economy and to our ability to solve challenges from climate to COVID."<sup>21</sup>

In other words, China could be and, in fact, needed to be, reintegrated into the extant international order, an order of international institutions, of comity and collaboration among nations, and of market-based principles (sometimes referred to as the Washington Consensus). Blinken's speech in that sense was retrospective in that it still sought an ordering within a system in which international economic competition could still be managed to produce win-win scenarios. China was no longer a youthful aspiring power to be turned into a responsible stakeholder within the liberal international order. It was instead something of an errant prodigal power that has to be forced, if need be, to re-enter it.

A September 2022 speech by National Security Advisor Jake Sullivan at the Global Emerging Technologies Summit, hosted by former Google CEO Eric Schmidt's Special Competitive Studies Project, provided an even more expansive version of economic strategy, with an especial emphasis on China as a rival and competitor. In somewhat unprecedented fashion for a national security advisor, Sullivan discussed not simply geopolitical, but primarily economic and technological competition with China.<sup>22</sup>

Sullivan's remarks did not contradict Blinken's "invest/align/compete" approach. But his speech was a more forward-leaning attempt at economic strategy. It could even be read as challenging the notion of whether China could return to the international order at all in the foreseeable future. Sullivan referred to a US "modern industrial and innovation strategy." He presented it as holistic, involving a "deep integration of foreign policy and domestic policy." Moreover, Sullivan put US-China competition in very stark terms that sounded more like "winner take all" than "win-win": "We are facing a competitor that is determined to overtake US technological leadership and willing to devote nearly unlimited resources to

that goal.” For three critical technologies—“computing-related,” “biotechnologies and biomanufacturing,” and “clean energy”—the goal was not collaboration with China but quite the opposite: “Given the foundational nature of certain technologies,” Sullivan stated, “*We must maintain as large a lead as possible* [emphasis added].”<sup>23</sup>

Sullivan also set forth four pillars to this US economic strategy: invest in the science and technology ecosystem; nurture top STEM talent; protect US technology advantages; and deepen and integrate alliances and partnerships. These sounded very much like the first two “invest” and “align” parts of the 2022 NSS and Blinken’s speech. But the latter “compete” part, especially of the sort that Blinken indicated was mutually and globally beneficial and to the betterment of the overall international order, was absent.<sup>24</sup>

Sullivan’s speech was complemented by Secretary of Commerce Gina Raimondo’s remarks given at MIT in November 2022. She underscored how different the geopolitical environment was today by noting that China had abandoned any effort at a reformist path. The world was in a “dramatically transformed strategic environment.” And she, like Sullivan, provided a four-part strategy that in many areas overlapped what Sullivan had discussed in his September speech, and that also aligned with the NSS and Blinken’s “invest/align/compete” strategic typology: invest in competitiveness, innovation, and talent at home; harden defenses against threats to US workers, businesses and national security; align with allies and partners to shape the environment in regard to China; and finally continue to engage with China, although in ways “consistent with US interests and values.”<sup>25</sup> Yet this latter “compete” part was seemingly less hopeful sounding than Blinken’s remarks in regards to China’s reintegration into the international order. Toward the end of her speech, Raimondo noted that the United States had been overly sanguine about the benefits of that order: “For almost forty years, we championed the benefits of a robust trade and investment relationship with China, overlooking the long-term costs for the near-term benefits.”<sup>26</sup>

The year 2022 ended with what appeared with a relatively stable “invest/align/compete” strategic approach, though with a more forward-leaning variation proposed by Sullivan and Raimondo. And there was further perhaps at least an implicit questioning from Sullivan and Raimondo about whether it was even possible to re-institute China into the international order, and, even more funda-

mentally, whether that order had advantaged China and disadvantaged the United States.

But 2022 hardly gave the last word in economic strategy from the administration. In April 2023, Treasury Secretary Janet Yellen gave a speech at the Johns Hopkins School for Advanced International Studies that certainly appeared less assertive than Sullivan's or Raimondo's. Yellen asserted that the US economic approach to China had "three principal objectives," with the first the securing of national security objectives and the protection of human rights. But she quickly moved to the other two objectives, which were a "healthy economic relationship with China: one that fosters growth and innovation in both countries" and "cooperation [with China] on the urgent global challenges of the day" such as the macroeconomy, climate issues, and debt distress.<sup>27</sup>

Yellen further noted China's problems such as "vulnerabilities in its property sector, high youth unemployment, and weak household consumption," as well as other structural challenges such as an aging demographic and a productivity downturn. She pointed out that notions of US declinism had "always been proven wrong." Perhaps given this relative optimism, Yellen asserted that the United States did not seek a "winner take all" competition with China, and instead would take "narrowly targeted actions" (such as export controls, sanctions, investment reviews)—not to gain economic advantage, but rather to rectify specific wrong-doing.<sup>28</sup>

The speech appeared as something of a walk back after the more aggressive Sullivan-Raimondo speeches of the fall, and it met with some criticism.<sup>29</sup> Yet what Yellen asserted was not new at all, but what has sometimes been termed the "small yard, high fence" approach toward China (taken from a remark by former Secretary of Defense Robert Gates about China's technology theft, and often referred to in commentary about cybersecurity and innovation protection<sup>30</sup>). Namely, the United States would vigorously protect certain areas, but not be over extensive, and certainly not engage in all-out economic competition with China that could involve significant decoupling or other significant economic breakdown between the two countries.

Even more so, Yellen's speech was consistent with a worldview that sought China's re-entry into the international order whose free-market underpinnings remained sound and ultimately beneficial around the world. Her comments that US economic decline was exaggerated, and that China's economic troubles were

many were themselves arguments for her somewhat less robust economic strategy. Implied in Yellen's speech was that a too-robust industrial strategy was very likely an overreach, unneeded, and in contradiction to the US free market-oriented approach.

Just a week later, Jake Sullivan gave another speech, this time at the Brookings Institution, that was perhaps the most comprehensive economic strategy statement to date.<sup>31</sup> After first thanking the audience “for indulging a National Security Advisor to discuss economics,”—acknowledging how atypical it was—he immediately noted Yellen's speech the week before “on our economic policy with China.” Sullivan sought to differentiate his speech by indicating he would “zoom out to our broader international economic policy...to more deeply integrate domestic policy and foreign policy,” that latter phrase a restatement from his September remarks.

Sullivan's remarks indeed transcended a China-focused economic strategy. What he proceeded to do was to articulate “fundamental challenges” that called into question the free market underpinnings of the extant international order itself. First, he noted that America's industrial base has “hollowed out” based upon the false assumptions that “markets always allocate capital productively [and that] ...the type of growth did not matter.” Second, he asserted that the United States needed to adapt to a “new environment defined by geopolitical and security competition,” whereas it had previously relied on the premise that “economic integration would make nations more responsible and open.” Third, he referenced an “accelerating climate crisis,” and an accompanying need for energy transition. Finally, he challenged US wealth inequality and its “damage to democracy.”<sup>32</sup>

These challenges contrasted sharply with Yellen's statements that US decline was exaggerated. He then went further and laid out a near-futuristic set of propositions that in no way looked like a return to ways of old, in yet another economic strategy that was similar in some ways—but dramatically sharper and more robust in others—to the approach he set forth in September. As he did in his previous speech, Sullivan once again openly called for a “modern American industrial strategy,” though with more detail. This strategy would identify “specific sectors” that are “foundational to economic growth.” It would deploy public investment and would enable private business to innovate, scale and compete. It would look to smaller scale industrial policy initiatives such as DARPA and NASA as precursors



and inspirations. Along with working with partners to build capacity and resilience, Sullivan also called for the United States to move beyond “traditional trade deals to innovative new economic partnerships.” His proffered strategy would work on everything from ending the global “race to the bottom on corporate taxes” to reforming the “multilateral trading system.” Sullivan also looked beyond the World Bank to regional developmental banks to help mobilize “trillions in investment into emerging economies.”<sup>33</sup>

After such a bravura exposition, remarks even on China seemed somewhat shrunken in significance, though he did offer some. He underwrote the Blinken/Yellen position with statements such as “We are competing with China on multiple dimensions, but we are not looking for confrontation or conflict,” and “We’re looking to manage competition responsibly and seeking to work together with China where we can.” Yet Sullivan’s broad scoped propositions that preceded his China remarks seemed at odds with the foundations of the Blinken/Yellen position. In its very capaciousness, in its broadly gauged themes, Sullivan’s speech called into question not only the “small fence/high yard” approach but also whether the notion of China returning to the global order was an enterprise that was even possible, given that that order itself was subject to question. After all, Sullivan’s call for a modern American industrial, sectoral strategy, for a new understanding of trade and global taxation, and for a shift beyond international institutions to more regional ones was hardly an affirmation of the global status quo.

## Mixed messages on US economic strategy

If there are two economic strategic approaches, then, in this administration—the “small yard, high fence” that Yellen and perhaps Blinken affirm, and the more full-throated “industrial strategy” that Sullivan and perhaps Raimondo proposes, they operate from different premises. Yellen’s approach especially does not advocate for extreme measures because there is no reason to do so. The current international order is sound; China is only a deviant from it. Sullivan, on the other hand, appears to view that order with much greater skepticism. That order, or at least a somewhat complaisant attitude toward it, is partially responsible for China’s economic rise and at least some of America’s corresponding economic decline. Whether either of the two approaches will “prevail,” or whether there will be some combination of the two remains in question.

Three considerations that may be influential should be kept in mind.

The first is political. The current administration staked its accession to power on a promise to return the US to normalcy within the international order. This order is premised on free trade, the free flow of capital, and the capacity of international institutions. It rests on the assumption that globalization is not only inevitable but ultimately beneficial. Movements toward a robust “industrial strategy” may strike many observers that the administration is shifting away from its promise to “return to order” toward a more nationalized and even transactional economic modality. Some tension can already be felt in, for example, complaints from allies and partners about the Buy America provisions in the Inflation Reduction Act.<sup>34</sup>

The second is institutional. Both the Departments of State and Treasury have outsized international equities that the National Security Council and the Department of Commerce do not. Regardless of administration, a commitment to the liberal international order, in its geopolitical and economic manifestations, is deeply rooted in State and Treasury. The Department of State as an institution has an understandable, long-enduring commitment to this order that it largely helped to construct over the past three-quarters of a century. From Marshall to Acheson, from Dulles to Kissinger, from Shultz to Baker, and even beyond past the end of the Cold War, for all its flaws, this order has lasted without resort to cataclysmic planetary war. Likewise, the Department of Treasury has a long-standing commitment to that order’s corresponding market economic principles, as evidenced by its long-standing commitment to free trade, capital markets, and attendant international institutions. In other words, the speeches made by Secretaries Blinken and Yellen are speeches also made with their institutions’ own memories and convictions, which are not easily dismissed or overcome.

The third has to do with the vicissitudes of history itself. Prognosticators have long predicted China’s imminent collapse.<sup>35</sup> “Peak China” is a recurring trope inside and outside the Beltway.<sup>36</sup> China’s economic slowdown, even pre-Covid, was evident. And while its initial post-zero Covid numbers seem encouraging,<sup>37</sup> there is a widespread feeling that China’s problems, from demographics to excessive debt, are simply too large. Other rivals to the United States including Japan have come and gone. Paul Samuelson’s infamous economics textbook with its notorious graph showing that the Soviet GDP would surpass the United States in the mid-1980s particularly comes to mind.<sup>38</sup> There is the thought among a significant num-

ber of policymakers and pundits that America should not let loose on a full-out “industrial strategy,” but keep its proverbial powder dry: let China economically self-destruct, or at least significantly diminish, on its own.

### **Flexible, Pragmatic, Adaptable Leadership—Regardless of Strategy**

Whether and how these considerations will matter, and whether one strategic approach will be favored more than the other, or whether they will somehow combine is an open question. Regardless of the strategic approach, leadership for any US. economic strategy should be flexible, pragmatic, and adaptable.

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*The views expressed are the author's alone, and do not represent the views of the U.S. Government or the Wilson Center.*

CHAPTER FIVE

# How Japan Defines Economic Security

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*Photo courtesy: paparazza / Shutterstock*

## Summary:

Japan's post-war economic strategy had focused on growth and expansion into international markets. The rise of China as a security threat as well as an economic rival, however, has led the Japanese government to fundamentally reevaluate its approach to national security by implementing policies intended to shore up economic security. There was a sea change in 2014 under the Liberal Democratic Party, which then accelerated in 2017, and culminated in 2022 with the development and passage of the Economic Security Promotion Act together with a new National Security Strategy.

Japan's initiatives focus on four key areas deemed vital for success in competing against China. The Japanese government is focusing on 1) securing the stable supply of critical commodities, 2) ensuring the safety of key infrastructure, 3) supporting the development of cutting-edge critical technologies, and 4) a secret patent system.

Although challenges remain, particularly Chinese threats in the cybersecurity realm, the United States and Japan are committed to enhancing their economic security.

## Policy Implications:

- The United States and Japan are increasingly aligned on the need to compete with China in the realm of economic security. For Tokyo, this represents a seismic shift in thinking and embrace of national security considerations. Although challenges remain, both countries should rest assured that they can rely upon each other to secure their economies from China.
- The United States and Japan should strengthen cooperation in the field of cyber defense to protect our key technologies, which are the source of our national strength.
- Both countries should cooperate to protect critical infrastructure, which is the foundation of national security and economic activities, from Chinese cyberattacks.
- Washington and Tokyo should work together to reduce vulnerability to disruption of strategic goods and supply chains.

The May 2023 G7 Hiroshima Summit attracted much attention with the participation of Ukrainian President Zelensky and the wreath-laying ceremony at the Hiroshima Peace Memorial Park by the heads of state. From the perspective of economic and national security policies, however, the fact that economic security was featured at the G7 summit was particularly noteworthy. Moreover, the G7 leaders adopted the statement, “Economic Resilience and Economic Security.”<sup>39</sup>

Although the Summit communiqué avoided addressing China by name, it confirmed that the G7 would work together in approach to economic resilience and economic security based on diversification, deepening partnership, and “derisking,” rather than decoupling.<sup>40</sup> The term “derisking” is used primarily in the financial sector,<sup>41</sup> and it is rapidly gaining attention in a geopolitical sense.<sup>42</sup> It is not clear what kind of negotiation process led to the adoption of this term in the communiqué, but given that it appeared in a speech given by EU Commission President von der Leyen on March 30,<sup>43</sup> it is reasonable to assume that it was included at the strong request of the European countries.

Even if the concept of economic security has been softened in expression from decoupling to derisking, the implications are clear. The conclusions that can be drawn from the Summit are that first and foremost of all, the advanced economies including Japan and the United States have recognized that China is a country with different values from those of the West and is attempting to change the current international order. Second, even if they do not sever economic, social, and political ties with China, they are trying to take a different and tougher approach toward China. Finally, they are trying to win the geopolitical competition with China by strengthening economic security.

The G7 leaders noted that “ensuring economic resilience and economic security globally remains our best protection against the weaponization of economic vulnerabilities,”<sup>44</sup> identify five measures to strengthen economic security, namely: 1) building resilient supply chains, 2) enhancing security and resiliency in critical infrastructure particularly in the digital domain, 3) responding to non-market policies and practices to secure global economic resilience, 4) addressing economic coercion to explore coordinated responses, deter and, counter economic coercion, 5) countering harmful practices in the digital sphere, 6) cooperating on international standards setting, 7) preventing leakage of critical and emerging technologies.<sup>45</sup>

This new framework of economic security proposed at the G7 Summit is

somewhat complicated, combining the old concepts of economic statecraft and the use of economic tools in national security. The concept of economic security had been gaining attention rapidly in Japan not only because of Japan's geographical location at the forefront of competition with China, but also because of the fact that Japan was the first country to face restrictions on rare earth exports from China in 2010, when foreign policy tensions between the two in the East China Sea became acute.

## The rise of the economic security debate

Behind the emergence of the debate over economic security in Japan are major structural changes in international politics.

During the four decades of the Cold War from 1946 to 1989, a “strategic competition” for survival existed between the socialist camp led by the Soviet Union and the democratic and free economic camp led by the United States. The perception of great power competition<sup>46</sup> was shaped by Churchill's Iron Curtain speech<sup>46</sup> and George Kennan's X Article.<sup>47</sup> This great power competition continued for almost 40 years, a period during which the logic of security took precedence over the logic of economics in international relations.

From the end of the Cold War in 1989 to around 2019 was an era of globalization during which major tensions in international politics subsided, economic logic took precedence over the logic of security, and people, goods, and money moved actively across borders.

However, this era of prioritizing economic logic came to an end with the rise of China. Discussions of “economic security,” such as economic statecraft and stricter trade controls, have been gaining momentum in other countries because the rise of China is shaping the narrative that international politics is once again moving toward “strategic competition.”

US Vice President Mike Pence's October 2018 speech suggested that the US should be prepared for great power competition with China and clearly stated adopting a new approach to China.<sup>48</sup> The US media determined that Pence's speech implied the start of a new Cold War between the US and China.<sup>49</sup> In 2021, an article corresponding to Kennan's “X Article” was published on the website of the Atlantic Council.<sup>50</sup> The article, titled “Longer Telegram: Toward a new American China strategy,” was written anonymously by a former US government

official in reference to Kennan's "Long Telegram," and called for a new US strategy toward China to counter Beijing's long-term strategy to surpass the United States and be implemented together with its allies.

The Chinese economy is projected to overtake the US economy to become the world's largest around 2030 and continue to develop until around 2050,<sup>51</sup> when the US economy will again overtake the Chinese economy, which is slowing down due to population decline.<sup>52</sup> Therefore, for at least the next 30 years, a "strategic competition" between the authoritarian camp, which combines Chinese-style socialism and a digital surveillance society, and the liberal democratic camp, led by the United States, is likely. The next 30 years will be the era of the "New Cold War," during which the logic of security will take precedence over the logic of economics, just as it did during the Cold War.

Based on this recognition of the strategic environment, the debate on economic security in Japan has been shaped as follows.

## **The road to Japan's Economic Security Promotion Bill**

Looking back at the evolution of the economic security debate, since the establishment of the National Security Secretariat in the Cabinet of Japanese Government in January 2014, the issues of land acquisition by foreigners, technology transfer through investment and acquisition of Japanese companies by foreign capital, and technology outflow from universities and companies by foreigners have emerged.

The "Diet Members Caucus for Rule Formation Strategy" of the ruling Liberal Democratic Party (LDP) was established in 2017, chaired by H.E. Akira Amari, a member of the House of Representatives and a former Minister of State for Economic and Fiscal Policy, to address these issues of security concern, next-generation technologies, and the need to formulate international standard rules. The Diet Members Caucus released a policy proposal titled "Establishment of a National Economic Council (Japanese version of NEC)"<sup>53</sup> on March 20, 2019, and submitted the proposal to Prime Minister Abe.

The proposal presents the following as its recognition of the situation: 1) intensifying competition between the United States and China has developed into a confrontation over technology, resources, and rule-making; 2) high-tech friction and the struggle for data (digital) supremacy are occurring between the US and



China, and intelligence activities are becoming more active; and 3) economic statecraft (pursuing national interests through economic means) is becoming more intense. In order to counter China's economic statecraft, the proposal proposed the necessity of establishing a "National Economic Council" (a Japanese version of the NEC). Specifically, it is necessary to create a "National Economic Council" to formulate strategic foreign and economic policies, strengthen restrictions on exports of cutting-edge technologies, tighten investment monitoring of foreign companies, impose economic sanctions, manage intellectual property, and formulate rules for international standards.

Reflecting these recommendations, the Economic Security Unit was established within the National Security Secretariat on April 1, 2020. The Economic Security Unit focuses on: 1) technology security, including export control, foreign direct investment regulations, technology transfer regulations, supply chain risks, etc., 2) cyber security, including the security of the next-generation mobile communication infrastructure, cyber security, cyber security information sharing, data security, etc., 3) International cooperation, including international coordination for infrastructure development in each country, international coordination for the development of high-tech technologies.

Following a series of discussions on the issues of technology transfer through investment and acquisition of Japanese companies by foreign capital, the Foreign Exchange and Foreign Trade Law was revised in June 2020, and the related ministerial ordinances and public notices were fully applied. The amendment to the Foreign Exchange Law lowered the threshold, from 10 percent to 1 percent, for prior notification at the time of acquisition of national security sensitive industrial companies, such as defense, aircraft, space exploration, nuclear power, cyber security, and critical infrastructure. The prior notification system was introduced for the appointment of directors, auditors, and other officers, the transfer or abolition of businesses in industries designated as important to national security.

Regarding to the discussion on the issues of land acquisition by foreigners, the Act on the Review and Regulation of the Use of Real Estate Surrounding Important Facilities and on Remote Territorial Islands was passed by a Diet and enacted in June 2021. Under the Act, the Prime Minister designates Monitored Areas, the land and surrounding areas of 1) defense facilities, nuclear facilities, and other facilities of national security importance, and 2) remote border islands, conducts

a review of the use of real estate in monitored areas, and prohibits the use of real estate of national security concern.

Serious discussions within the ruling LDP led to the Economic Security Promotion Bill in 2022. In response to the activities of the “Diet Members Caucus for Rule Formation Strategy” mentioned earlier, Policy Research Council of LDP established the “Strategic Headquarters on the Creation of a New International Order” on June 4, 2020, under the direction of then Policy Research Council Chairperson of LDP, now the Prime Minister H.E. Fumio Kishida.

On December 22, 2020, the Strategic Headquarters issued a recommendation titled “Toward Developing Japan’s ‘Economic Security Strategy.’”<sup>54</sup>

The recommendation consists of five chapters: the need to develop Japan’s “Economic Security Strategy”, fundamental principles and definition of economic security, economic security environment surrounding Japan, basic policy on economic security, and priorities and measures to be taken. This recommendation is an important text for understanding Japan’s concept of economic security.

In Chapter One of the recommendation, “need to develop Japan’s Economic Security Strategy,” presents the following perception: 1) some countries are using economic means as “weapons” to pursue their own interests, 2) strategic thinking is needed to ensure national independence and survival, and maintain universal values, and 3) economic security strategy formulation is necessary. In Chapter two, economic security is defined as ensuring Japan’s independence and prosperity, protecting an international order based on fundamental values of freedom, democracy, and rule of law, and ensuring “strategic autonomy and strategic indispensability,” which are presented for the first time as the basic concept to achieve the economic security. Chapter 4 presents the basic policies to ensure economic security: 1) to identify vulnerabilities, improve robustness, and reduce dependence in order to maintain and strengthen strategic autonomy; 2) to create an environment for the maintenance and development of industries with advantages in order to acquire strategic indispensability; and 3) to identify, preserve, and foster technologies with autonomy and indispensability.

This recommendation is characterized by the need for an overarching, comprehensive response in a wide range of 16 areas to achieve economic security. Specifically, the proposal addresses the following areas: securing resources and energy, ocean development, strengthening food security, financial infrastructure

development, information and telecommunications infrastructure development, space development, strengthening cyber security, utilizing data, diversifying and strengthening supply chains, securing and maintaining technological superiority, improving innovation, land transactions, large-scale infectious diseases counter-measures, infrastructure exports, involvement in international rule-making, and strengthening economic intelligence capabilities.

## **Economic Security Promotion Bill of 2022**

In response to the LDP's recommendations, the Cabinet Secretariat established the "Expert Panel on Economic Security Legislation" on November 26, 2021. The Panel proposed the final report on February 1, 2022.<sup>55</sup> While the LDP's proposal suggested initiatives in 16 areas, the recommendations of the government's Expert Panel were significantly reduced to four areas. The recommendations identified four areas that should be addressed first through legislative measures: 1) strengthening supply chains for critical goods and raw materials, 2) ensuring the safety and reliability of key infrastructure functions, 3) a framework for fostering and supporting key technologies in the public and private sectors, and 4) preventing the outflow of sensitive inventions by secret patents.

Then, the House of Councilors passed by majority vote the Economic Security Promotion Bill on May 11, 2022, which came into effect on May 18. The bill consists of four pillars, as the Expert Panel proposed: 1) securing the stable supply of critical commodities, 2) ensuring the safety of key infrastructure, 3) supporting the development of cutting-edge critical technologies, and 4) a secret patent system. A document released by the Cabinet Secretariat explains the purpose of the bill as the establishment of a basic policy and system to comprehensively and effectively promote economic measures to ensure security in light of the increasingly complex international situation.

## **Conclusion and Future Perspective**

Although the Economic Security Promotion Act was enacted following the process described above, there are several challenges that need to be resolved for the future.

One of the challenges is the enhancement of policies in cyberspace. In the field

of cyber security, the second pillar of the Economic and Security Promotion Act aims to ensure safety and reliability related to the maintenance of Japan's core infrastructure with attention to cyber security. However, the bill does not include any cyber security measures to prevent the cyber theft of intellectual property. It is hoped that the bill will be revised in the future to provide for proactive cyber defense and legislation to prevent state-sponsored cyber theft.

In cyberspace, cyber theft against companies listed as priority areas in "Made in China 2025,"<sup>56</sup> announced by China's State Council in May 2015 as the 10 key areas necessary for China to rise to the leading position of a manufacturing powerhouse, are on the rise. Chinese cyber attackers are targeting the following industries that have been identified as key areas of development in "Made in China 2025": 1) next-generation information technology, 2) new energy automobiles, 3) aerospace, 4) marine engineering, 5) new materials, and 6) power equipment.

Such cyber theft threatens the technological superiority of developed countries by resulting in the unfair forced transfer of technology possessed by them as a result of the attacks. It also poses not only a security problem but also a major threat to the free trade regime. There have been cases of Chinese companies manufacturing and exporting products for developing countries using technology obtained through such unfair means, which could shake confidence in the free trade system based on free and fair rules.

It can thus be claimed that these cyber-espionage activities are linked to China's long-term strategy for seeking technological and economic supremacy. There is a risk of long-term and strategic "technology leakage," which would ultimately damage Japan's industrial competitiveness. Thus, it is clear that the cyber domain has become a real battleground over economic security between China and developed Western countries, including Japan. In order to protect industrial competitiveness, preventing cyberattacks by China is now an urgent and important issue.

Both Japan and the United States have revised their national security strategies in 2022. The Biden administration's new National Security Strategy<sup>57</sup> focuses on integrated deterrence as a means of achieving security. This concept encourages a shift from traditional security, which has traditionally focused on diplomacy and the military, to a security that makes full use of all means, including economic and intelligence, and means mobilizing all "DIME" to play a serious game in the interregional competition for survival.<sup>58</sup> The revision of Japan's National Security

Strategy also marks a major turning point in Japan's post-World War II national security policy.<sup>59</sup>

It is important that the United States and Japan cooperate in the area of economic security in order to compete with China. The following areas for cooperation are particularly important: 1) Strengthen cooperation in the field of cyber defense to protect our key technologies, which are the source of our national strength, 2) Both countries should cooperate to protect critical infrastructure, which is the foundation of national security and economic activities, from cyberattacks, 3) Both countries should work together to reduce vulnerability to disruption of strategic goods and supply chains.

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CHAPTER SIX

# Supply Chain Resilience and the Innovation Challenge

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*Photo courtesy: Blue Planet Studio / Shutterstock*

## Summary:

Supply chain resilience is at the heart of economic security in the face of pandemic disruptions and the threat China poses to national security for both the United States and Japan. Both Tokyo and Washington have pursued “onshoring,” or the boosting of domestic production capabilities and supply chains, to offset dependence upon vulnerable supply chains overseas. Yet, dependence upon Chinese goods remains high, particularly for Japan.

Onshoring alone is insufficient to reduce dependence upon Chinese supply chains, and “friendshoring,” or the relocating of manufacturing and supply chains to friendly allies and partners in emerging markets must be part of the policy conversation on economic security. Often referred to as a “China plus one” strategy, expanding supply chains amongst countries with minimal security concerns will reduce risks and dependence upon China. Looking beyond manufacturing, Japan and the United States should also embrace international research collaboration on technology, or “knowledge friendshoring.”

Economic security requires balancing national security concerns and economic growth. Reducing risks likely necessitates expanding domestic production alongside efforts to diversify supply chains abroad, both in traditional sectors and the knowledge economy.

## Policy recommendations:

- Economic security requires balancing national security needs and economic growth across a wide variety of governments, private sector actors, and stakeholders. Securing supply chains will require Tokyo and Washington to look both at home and abroad.
- Japan and the United States should leverage multilateral frameworks (for example, the G7, IPEF, and SCRI) to invest in friendshoring to diversify supply chains and offset dependence upon China.
- “Knowledge friendshoring” can enhance international research collaboration and accelerate the development of technologies crucial for maintaining a competitive edge.

In recent years, the United States and its allies, including Japan and several European countries, have implemented policies aimed at derisking the supply chains of critical products from China due to national security concerns, particularly semiconductors. These policies involve incentivizing domestic production (onshoring) and imposing restrictions on international trade, technology transfers, and investments with China.

## Effects of decoupling policies

In Japan, the government has implemented various strategies to enhance supply chain resilience. Firstly, in 2019 and 2020, the government strengthened export controls and imposed restrictions on foreign direct investment (FDI) in high-tech sectors. Secondly, since 2019, Japan provided subsidies to Japanese companies (beyond just semiconductor firms) for onshoring investments within the domestic market, as well as for diversifying production facilities in ASEAN countries.<sup>60</sup> Thirdly, the 2022 Economic Security Promotion Act enables producers of critical products, such as semiconductors and batteries, to receive subsidies and preferential loans by sharing procurement plans and inventory information with the government.<sup>61</sup> Fourthly, substantial subsidies, amounting to 620 billion yen, were recently granted to attract Taiwan's leading semiconductor firm, TSMC, to Kumamoto and to facilitate the expansion of plants for Kioxia and Western Digital in Mie, and Micron Memory Japan in Hiroshima.<sup>62</sup> Lastly, a subsidy of 70 billion yen was provided to Rapidus, a newly established semiconductor firm, to establish a production plant in Hokkaido and advance the development and production of next-generation semiconductors.<sup>63</sup>

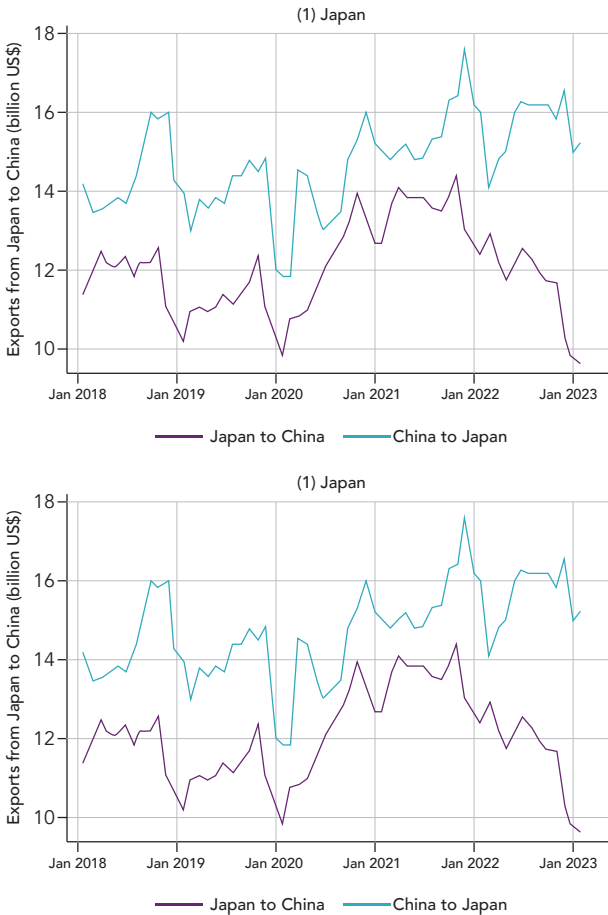
In response to these economic security policies, China has also tightened controls on exports and technology transfers of sensitive products since 2020.<sup>64</sup> Additionally, the Chinese government has offered significant subsidies to its high-tech sectors, with 40 billion RMB (\$6 billion US dollars) in 2015 and 100 billion RMB (15 billion US dollars) in 2020, as reported by METI.<sup>65</sup> These measures were implemented even prior to the US-China decoupling period.

Despite of these decoupling policies, overall trade volumes between Japan and China and between the United States and China, have not experienced significant declines, particularly when compared to the pre-COVID-19 period (Figure 1). An exception is the decline in monthly exports from Japan to China, which



decreased from a peak of 14 billion dollars in October 2021 to 10 billion dollars in February 2023. However, it is important to note that this sharp decline may be temporary or influenced by exchange rate fluctuations. Trade data from Japan’s Ministry of Finance reveals that exports from Japan to China in March 2023 amounted to 1.55 trillion yen, a figure comparable to 1.68 trillion yen in March 2022 and 1.63 trillion yen in March 2021.

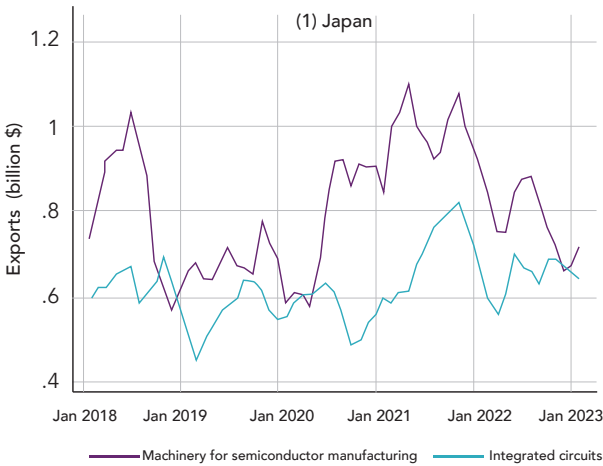
**Figure 1: Trade of Japan and the United States with China**

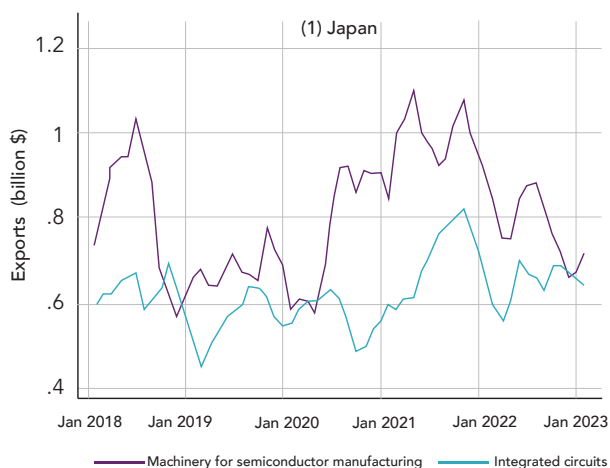


Source: UN Comtrade. Note: 3-month moving averages are shown.

Trade of semiconductor-related products have been affected more than overall trade. Figure 2 illustrates a significant decline in exports of machinery for semiconductor manufacturing and integrated circuits from the United States to China since early 2021. Similarly, Japan semiconductor manufacturing machinery exports fell, while exports of integrated circuits have remained stable. This stability may be attributed to the fact that Japan’s integrated circuits are predominantly of standard quality, making them less subject to heavy restrictions compared to state-of-the-art versions.

**Figure 2: Exports of Semiconductor-related Products from Japan and the United States to China**





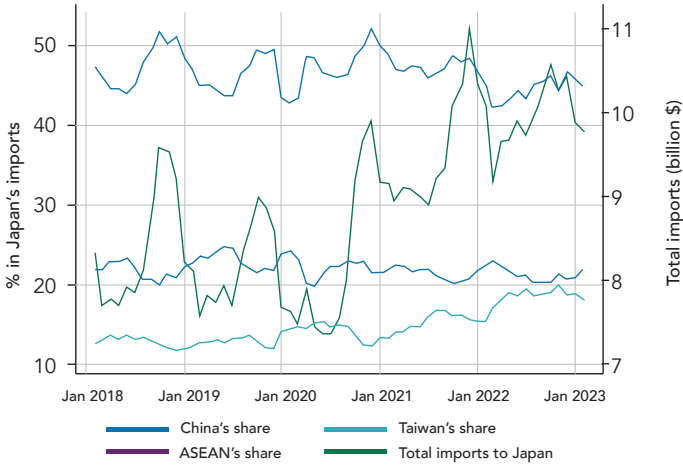
Source: UN Comtrade. Notes: 3-month moving averages of exports of HS codes 8486 and 8542 are shown.

These figures demonstrate the successful implementation of export restrictions on sensitive products to China for national security reasons while overall trade with China remains steady. Both Japan and the United States have effectively balanced their national security concerns with their economic interests, achieving a state of partial decoupling that avoids complete separation, which would be detrimental to both objectives.

## Heavy Reliance on China in Supply Chains

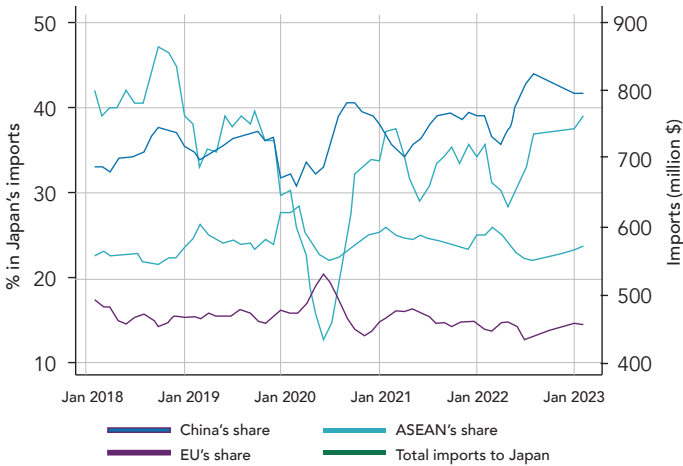
However, a significant challenge persists in trade with China, namely the heavy dependence on China as a supplier of materials and parts. This issue is particularly critical for Japan, where China accounts for 45 percent of imports of electrical machinery and electronic devices, as well as 42 percent of automobile parts imports (Figures 3-4). Moreover, the share of China in auto parts imports is not decreasing over time. Rather, it is exhibiting an increasing trend (Figure 4).

**Figure 3: Japan’s imports of electrical machinery and electronic devices**



Source: UN Comtrade. Notes: 3-month moving averages of imports of HS code 85 are shown.

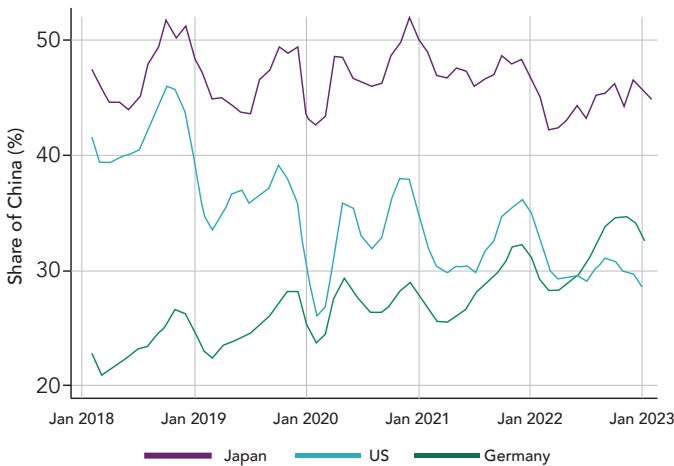
**Figure 4: Japan’s imports of automobile parts**



Source: UN Comtrade. Notes: 3-month moving averages of exports of HS codes 8705, 8706, 8707, 8708, 870990, and 8714 are shown.

By contrast, the United States has made substantial strides in reducing its reliance on China for imports of electrical machinery and electronic devices since the onset of the US-China trade conflict in 2018 (Figure 5). While the share of China in imports was similar for both countries in 2018, it currently differs by 15 percentage points. Figure 5 also demonstrates that the reliance of Germany on China has significantly and consistently increased since 2018 and currently surpasses the level of the United States.

**Figure 5: Share of China in imports of electrical machinery and electronic devices for selected countries**



*Source: UN Comtrade. Notes: 3-month moving averages of the share of China in imports of HS code 85 are shown.*

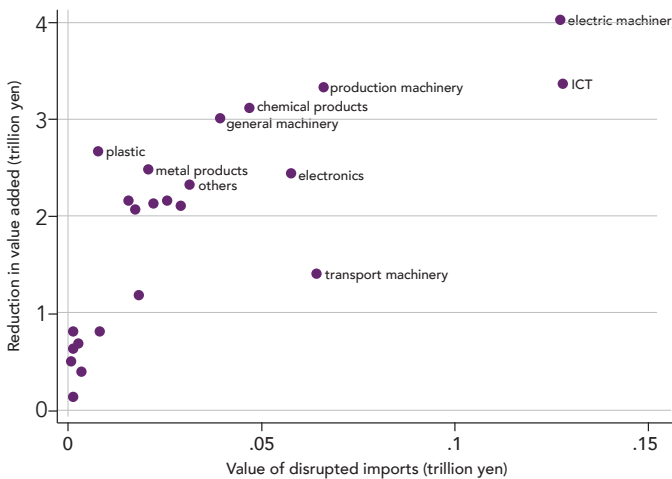
The heavy dependence of Japan's supply chains on China entails significant economic risks. Should imports from China diminish due to national security concerns, including during a possible Chinese invasion of Taiwan, the resultant economic losses would extend beyond the mere value of those imports. Disruptions in the inflow of materials and parts would precipitate declines in the production levels of downstream companies, thereby amplifying the adverse effects throughout the entire supply chain.

Together with Hiroyasu Inoue of the University of Hyogo, I conducted a simulation to assess the impact of import disruptions from China on Japan's

production. This analysis utilized data encompassing over one million firms and more than four million supply-chain relationships.<sup>66</sup> The findings revealed that if 80 percent of imports from China were disrupted for a two-month period, Japan's value-added production would decrease by roughly 13 trillion yen, despite the disrupted imports amounting to approximately 1.4 trillion yen. This decrease represents approximately 15 percent of value-added production over the same two-month period. In essence, the reduction in value-added production would be nearly ten times greater than the value of the disrupted imports.

Furthermore, our simulation examined the repercussions of import disruptions across specific sectors, as depicted in Figure 4. It becomes evident that the impact of import disruptions on the electrical and information and communication equipment industries is particularly substantial. However, even in sectors such as machinery, metal products, chemicals, and plastics, where the value of disrupted imports is relatively small, the disruptions would still engender notable declines in production. This is primarily due to the utilization of imported materials and parts in the upstream segments of Japan's domestic supply chains. Consequently, when upstream materials and parts become unavailable, a larger number of downstream companies are adversely affected, leading to a more pronounced overall economic loss.

**Figure 6: Effect of disruption of imports from China to each industry in Japan on Japan's value added production**



Source: Inoue and Todo (2022). Note: This figure shows simulation results assuming disruption of imports from China to each sector shown by each dot by 80 percent for two months.

## Limitations of onshoring

To address the adverse effects of import disruptions from China arising from national security concerns, it is imperative to strategically reduce heavy dependence on China.

One viable approach is the promotion and attraction of domestic manufacturing facilities, commonly known as onshoring. Presently, countries such as the United States, Japan, and European nations are implementing policies to incentivize onshoring, which is essential for enhancing the resilience of supply chains. Furthermore, onshoring holds the potential to invigorate and rejuvenate the domestic economy. For instance, substantial subsidies have been allocated to attract TSMC's plant to Japan, leading to the formation of industrial clusters in proximity to the facility, comprising semiconductor user firms, material suppliers, parts manufacturers, and machinery producers. If these clusters foster technological advancements through knowledge sharing within the region, the subsidies will yield significant economic benefits.

Nonetheless, it is crucial for both the government and private sector to acknowledge the limitations of onshoring. Firms expand their operations overseas primarily to achieve production efficiency,<sup>67</sup> and therefore, an excessive emphasis on onshoring could undermine the efficiency and international competitiveness of domestic firms. Notably, Japan has witnessed a rapid increase in imports of electrical and electronic products (Figure 3), making it impractical to substantially replace these imports with domestic production.

Furthermore, industrial policies that provide subsidies to specific industries do not guarantee success. Even in the case of China, often cited as a successful example of industrial policy, productivity improvements resulting from such policies were observed only when competition within the industry was maintained.<sup>68</sup> Therefore, for the current industrial policies of the United States, Japan, and European countries to succeed, it is crucial to implement them while fostering competition instead of resorting to protectionism.

Moreover, there are inherent risks associated with disruptions in domestic supply chains. Japan and the United States, in particular, are susceptible to natural disasters that can significantly disrupt domestic supply chains. For example, predictions indicate that severe disasters, such as the Nankai Trough earthquake,

the Tokyo metropolitan earthquake, and the eruption of Mount Fuji, could cause substantial damage to Japan's industrial clusters in the near future. Consequently, an excessive concentration of production facilities domestically poses significant risks that must be duly considered.

## Risk mitigation through friendshoring

Therefore, to reduce dependence on China and mitigate the negative impacts of import disruptions, it is crucial, in addition to facilitate onshoring, to expand supply chains among countries with minimal security concerns. This strategy, known as friendshoring, involves diversifying production plants and procuring materials and parts from diverse sources in friendly countries. By doing so, even if supply chains are disrupted due to national security issues, it would be relatively easy to find alternative sources and mitigate the impact.

The importance of diversification in supply chain resilience is supported by various studies. For instance, a study examined the propagation of the economic impact of Hurricane Sandy through supply chains.<sup>69</sup> It found that firms connected to overseas firms in addition to firms in the affected region experienced smaller reductions in post-disaster sales than those connected to only directly affected firms. Similarly, another study analyzed firm-level data from ASEAN countries and India during the COVID-19 pandemic and discovered that firms with major suppliers in multiple countries exhibited greater resilience compared to those reliant on a single country.<sup>70</sup>

Recognizing the benefits of diversification, the private sector has taken measures to enhance supply chain resilience. Following the Great East Japan earthquake, which caused significant disruptions, Japan's automotive industry standardized parts and diversified its suppliers. This enabled the industry to minimize the impact of subsequent events such as the Kumamoto earthquake and the COVID-19 pandemic.<sup>71</sup> Currently, Japanese firms are actively pursuing not only onshoring but also diversification of production plants. According to a survey conducted by the Nikkei Newspaper in November 2022, 50 percent of Japan's top 100 manufacturing companies indicated a reduction in reliance on China, with Japan (86 percent), Thailand (76 percent), and Vietnam (72 percent) being mentioned as alternative destinations.<sup>72</sup>



Diversifying supply chains incurs costs for the private sector, such as information costs associated with finding suitable partners abroad.<sup>73</sup> However, the rising risks of dependence on China have made a China Plus One strategy, which involves maintaining production plants and procurement sources in at least one country other than China, cost-effective.

Figures 3 and 4 indicate that the share of imports of electrical and electronic products and automobile parts from ASEAN countries—strong candidates for the China Plus One strategy—to Japan has remained stagnant, suggesting room for expansion. However, diversification targets should not be limited to emerging economies, such as ASEAN countries for Japan, Latin America for the United States, and East Europe for Western Europe. Given the promotion of onshoring in Japan, the United States, and Europe, as well as the declining share of wages in total production costs due to robotics and ICT, strengthening supply chains among these advanced regions has become an important strategy. Moreover, less developed countries in South Asia, notably India, and Sub-Saharan Africa should also be targeted as linkages with the Global South have become crucial to both economic interests and national security.

To facilitate the diversification of supply chain partners through friendshoring, policies are necessary to address the externality caused by information spillovers. Even when firms obtain information on overseas partners on their own costs, it may spill over to other firms, reducing incentives to information collection in the market economy. Therefore, governments should provide public support for sharing information about foreign markets and facilitating business matching between domestic and foreign companies through export and investment promotion agencies, such as the Japan External Trade Organization (JETRO), which has proven to be effective.<sup>74</sup>

Furthermore, to accurately identify suitable countries for friendshoring, it is recommended to leverage existing multilateral frameworks such as the Group of Seven (G7), the Indo-Pacific Economic Framework (IPEF), and the Supply Chain Resilience Initiative (SCRI) involving Australia, India, and Japan. These frameworks can facilitate information sharing and business matching among countries. Notably, the previous G7 Summit held in Hiroshima, Japan marked a historic moment as supply chain resilience was discussed for the first time in the summits. Moreover, the participation of many non-G7 countries from the Global

South, such as India, Indonesia, and Brazil, in the previous G7 Summit strengthened their economic and political ties with the G7 that may be helpful to expand friendshoring. It is crucial to effectively utilize such multilateral frameworks to further promote friendshoring. Specifically, the G7 countries should foster win-win scenarios with the Global South by offering trade opportunities, as well as financial and technical support for innovation and infrastructure development within these frameworks.

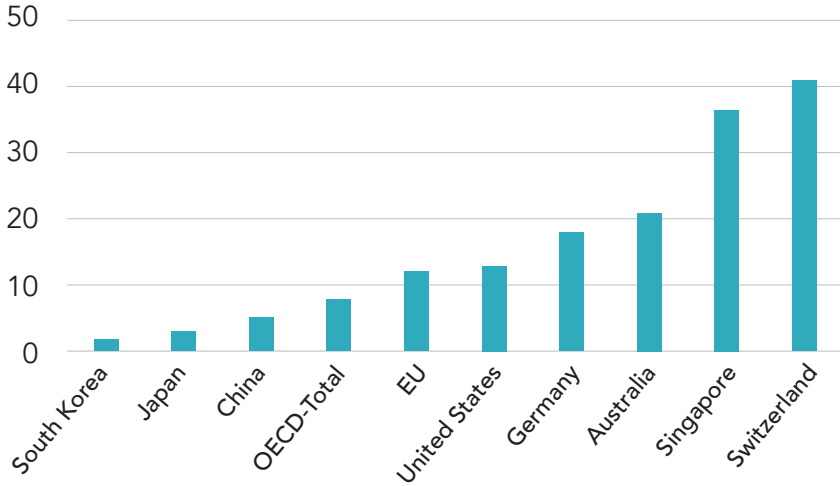
## Benefits of Knowledge Friendshoring

In order to enhance the robustness and resilience of supply chains, it is critical to elevate the level of technology. When the supply of a specific input, which is difficult to substitute, faces disruption, firms downstream can mitigate the negative impact by innovating their technology. This enables them to produce the input internally or explore alternative production methods that do not rely on the input. Toyota's development of new magnets for electric motors, reducing their dependence on rare earth minerals due to export restrictions from China, serves as an example of such innovative efforts.<sup>75</sup> Although Japan still heavily relies on China for rare earth minerals, these endeavors are essential for long-term supply chain resilience.

To effectively promote innovation, international research collaboration has proven to be highly valuable as cutting-edge innovation requires diverse knowledge.<sup>76</sup> An empirical study found that firms engaged in international research collaboration experience a 27 percent increase in the number of citations per patent, indicating higher-quality innovation.<sup>77</sup> In comparison, domestic collaboration yielded a 5.5 percent increase. These findings underscore the significance of international linkages for acquiring new knowledge and fostering innovation.

However, the level of international research collaboration among Japanese firms has been relatively low. In 2017, the share of international co-invention in total international patent applications by Japanese agents was only 3 percent, significantly lower than the 12-13 percent observed for the United States and the European Union (Figure 7).

**Figure 7: Share of International Co-invention (percent of Total PCT Patent Applications)**



*Source: OECD Science, Technology, and Innovation Scoreboard.*

Therefore, it is recommended to promote international research collaboration among friendly countries, which can be termed “knowledge friendshoring.” Policies are required to address the externalities associated with knowledge spillovers, as in the case of product friendshoring. Specifically, public support for information provision and partnership matching can effectively encourage knowledge friendshoring. Existing multilateral frameworks such as the G7, IPEF, and SCRI can also be utilized to provide such support.

The current landscape aligns with this suggestion. The previous G7 summit held in Japan recognized the importance of research collaboration among G7 countries. The Japanese government, apart from attracting TSMC’s production plant to Kumamoto, also facilitated the establishment of its research and development center in Tsukuba, promoting joint research with Japanese firms and universities.<sup>78</sup> Furthermore, the Japanese government established the Leading-edge Semiconductor Technology Center (LSTC) to foster the development of next-generation semiconductors through research collaborations between Japan and the United States.<sup>79</sup> Samsung Electronics from South Korea has also taken advantage of Japanese government subsidies to establish a semiconductor develop-

ment center in Yokohama and engage in joint research with Japanese material and machinery manufacturers.<sup>80</sup> These initiatives for knowledge friendshoring should be further strengthened, encompassing a wide range of industries rather than focusing solely on the semiconductor sector.

## Balancing national security and economic interests

It is critical for Japan, the United States, and European countries to reduce reliance on China in supply chains and promoting their friendshoring of products and knowledge to mitigate the risks associated with China's national security threats. However, the benefits of maintaining economic relations with China must be acknowledged, both for economic and political purposes. Maintaining a certain level of economic ties can also actually contribute to conflict prevention.<sup>81</sup> As such, while it is necessary to diversify supply chain partners for industries heavily dependent on China and minimize trade with China in products and technologies with significant security concerns, it is not advisable to drastically sever economic relations with China.

In practice, while both Japan and the United States have experienced a decline in exports of security-sensitive products, such as machinery for semiconductor manufacturing and integrated circuits, to China (Figure 2), overall trade has remained relatively stable or experienced only minor decreases (Figure 1). Such balance between national security concerns and economic interests should be maintained by careful policy making.

The views expressed are the author's alone, and do not represent the views of the U.S. Government or the Wilson Center.

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