

# Testing the Bond of Shared Economic Security Interests

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## 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.*



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