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AJRC Working Paper No. 01/2021

March 2021

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Keywords

Japan, economic security, trade policy, national security, Trans-Pacific Partnership

JEL Codes

F13, F15, F21, F31

Suggested Citation:

Armstrong, S., Urata, S., 2021. “Japan first? Economic security in a world of uncertainty”. AJRC Working Paper, March 2021. Australia-Japan Research Centre, Crawford School of Public Policy, The Australian National University.

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ISSN 0 728 8409

ISBN 978-0-86413-017-4

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Japan First? Economic security in a world of uncertainty

Shiro Armstrong and Shujiro Urata[1]

Abstract

Japan's economic and national security depends on managing its economic, political and security relationships with its security guarantor and ally, the United States, and largest trading partner, China. The rise of China and the America First agenda in the United States, that involves increased strategic competition and the trade war between these world's two largest economies, has meant a much more uncertain international policy environment for countries like Japan, the world's third largest economy. In this uncertain external policy environment Japan has shown international leadership in its initiative to conclude the CPTPP after the United States withdrew from the TPP, concluding the Japan-EU EPA and hosted the G20 summit. Japan has also signed a bilateral trade agreement with the United States that is a departure from multilateral rules and norms and introduced 'economic security' policies that include export controls and tightening of foreign investment regulations for security reasons.

Some small but potentially significant reforms to machinery of government have taken place in an attempt to better integrate economic policy with national security policy, resulting in the establishment of economic security divisions in key agencies and the Cabinet Office. There does not appear to be a clearly articulated or obvious framework of national security that includes welfare-enhancing economic security guiding policy.

The entanglement of economic and security for Japan has led to a series of policies that appear to promote national security interests over economic prosperity. This paper reviews these developments and raises questions as to whether Japan's 'economic security' policies are welfare enhancing or put national (or political) security interests ahead of welfare considerations. It is not clear that current economic security policies are consistent with Japan's external economic position and deep interest in the multilateral system that helps manage and support Japan's economic security interests.

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We are grateful to Yuma Osaki for excellent research assistance. All errors are our own.

Japan’s foreign economic position and security policy priorities

Japan’s national security depends on the US security umbrella, including its extended nuclear deterrence. The Japanese Self Defence Forces have gradually expanded their role and capabilities, including with the reinterpretation of the constitution to allow collective self defence, but the pacifist constitution limits Japan’s ability to defend itself. The reliance on the military alliance with the United States, that includes US bases in Japan, has grown with the growth in Chinese power and North Korean threat.

American leadership of the rules-based order, including the US security network that has secured stability in the Asia Pacific and the leadership of the global economic commons like the WTO, has allowed Japan and the broader region to prosper. It is within that framework that China made the commitments to open up its economy and develop to overtake Japan as the world’s second largest economy and become the largest trading nation. China is the largest trading partner for Japan and most countries globally.

Japan’s strategic priorities are in managing the US economic and security relationship, and the fears of alliance abandonment or entrapment, and the economic and political relationship with a rising China that is increasingly assertive. This challenge, which is not unique to Japan, is putting pressure on Japanese policy strategies.

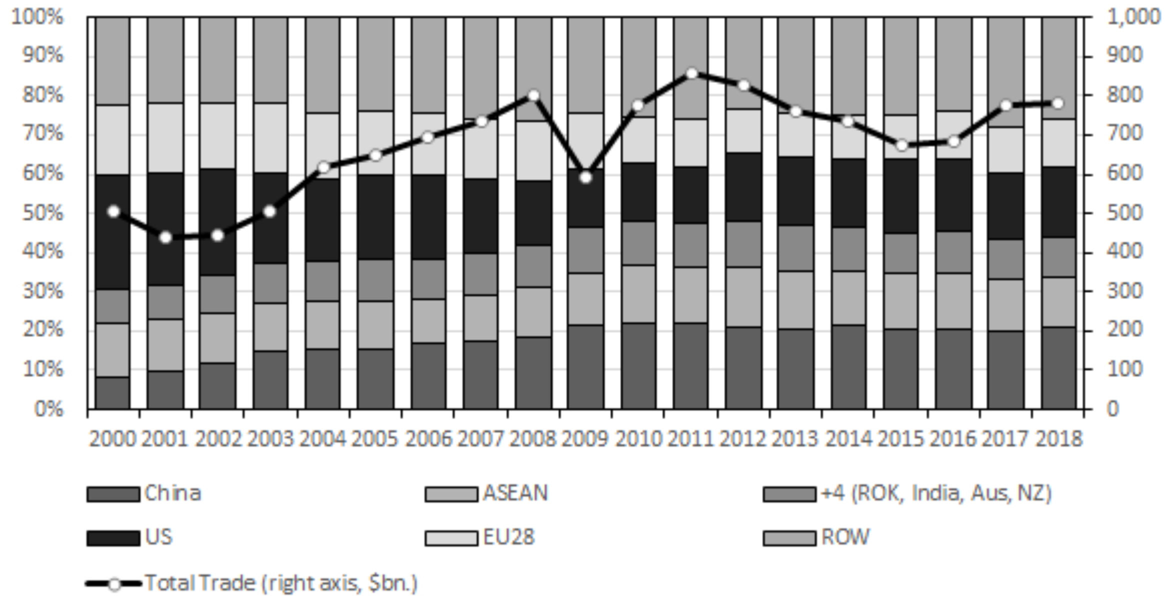
Japan may be the world’s third largest economy but its share of global trade has been falling. Japan’s international trade (exports and imports) increased 1.7 times in absolute terms from $882 billion in 2000 to $1,503 billion in 2018. However, Japan’s position in world trade declined during the 2000-2018 period, as trade by other countries grew faster. In terms of total trade, that is exports and imports, Japan’s share in world trade declined from 7.2 percent in 2000 to 4.2 percent in 2018.

China’s share in global trade increased remarkably from 4.7 percent to 12.1 percent during the 2000-2018 period. China accounts for 13.3 per cent of total global exports and 10.9 per cent of global imports. The corresponding shares for the United States declined from 16.2 percent to 11.1 percent. The US share of global exports fell from 12.9 to 8.4 per cent and imports from 19.4 to 13.7 percent over the same period. A shift from Japan and the US to China in their importance in world trade, which is mainly attributable to the differences in their economic growth rates, has important implications on international economic relations and China’s influence on the global economy has increased. This trend has accelerated, at least temporarily, as China — the source of COVID-19 and hit by the virus first — has managed to contain the coronavirus pandemic earlier and more successfully than the United States, Japan and other industrial economies in Europe.

The importance of the United States as a trading partner for Japan declined from 2000 to 2018 while the importance of China rose. In 2000 the United States accounted for 24.7 percent of total Japanese trade compared to 10.9 percent for China. By 2018, the share of the United States in Japan's total trade had fallen to 14.3 percent and China’s had risen to 21.5 percent. The United States was both the largest export destination and source of imports for

Japan in 2000, and by 2018 China was the largest. This shift was particularly notable in the case of exports compared to imports. China's share of Japan's total exports accounted for 8.2 percent on the eve of China's WTO accession in 2000, which grew to 21.2 percent in 2018. The United States accounted for 29.1 per cent of total Japanese exports in 2000 and that fell to 17.6 per cent in 2018 (Figure 1).

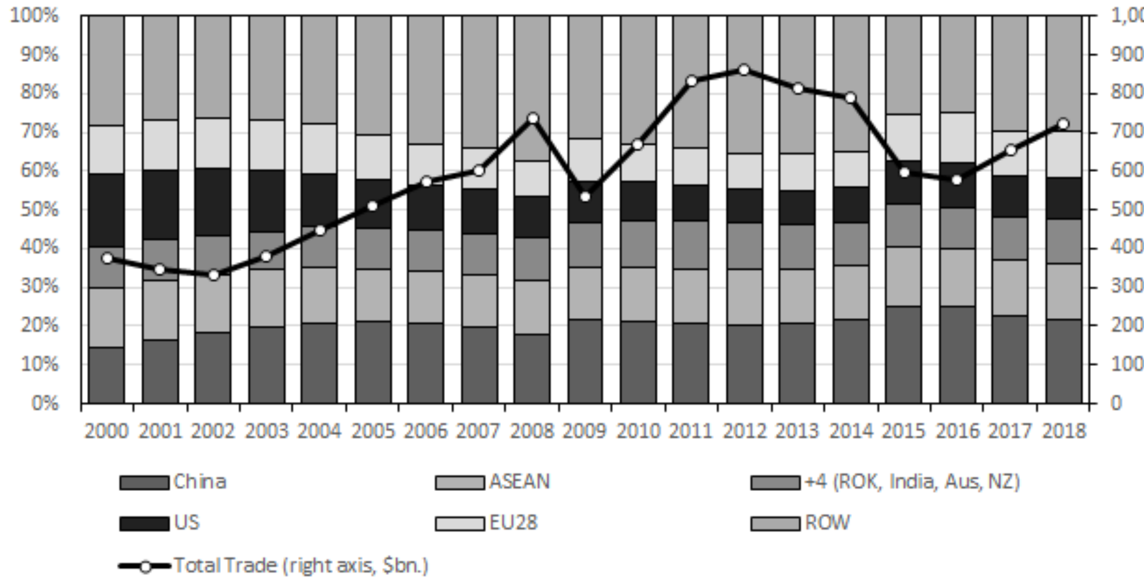
Figure 1 Japan's export destination by share and total exports, 2000-2018



Japan's dependence on China for its imports was 21.8 percent in 2018, which grew from 14.5 percent in 2018 while the US share of Japanese imports fell from 18.8 per cent in 2000 to 10.7 percent in 2018 (Figure 2). The structure of imports shows that Japan relies heavily on China for personal protective equipment (PPE) and electronics products, for example. For Japan, China is the source of 75 percent of imports of face masks, 66 percent of goggles, 53 percent of infection protective wear, 99 percent of laptops and tablet PCs and 86 percent of smartphone imports[2].

[2] The figures are for 2018 and computed from trade statistics compiled by Japan's Ministry of Finance.

Figure 2 Japan's import shares by source and total imports, 2000-2018



High trade shares with China have become a concern for some policymakers and businesses in Japan in the context of the China-US trade war. Chinese exports to the United States that embody Japanese parts and components or that are part of Japanese supply chains which include Japanese value-added have become exposed to US trade barriers. The high dependence on Chinese manufacturing for Japan's imports of PPE and other electronics has also brought concern about diversification of supply chains, as it has in other countries. There is also risk of interference in the market, both real and perceived, driven by political differences between Tokyo and Beijing.

Japanese firms have managed the ups and downs of political relations between Tokyo and Beijing, with past boycotts in China of Japanese goods having had little effect on the trade and investment relationship (Armstrong, 2012). The economic relationship has been managed under the multilateral rules-based trading system, with the rare earth elements dispute of 2010 having been resolved in the WTO dispute settlement system with China accepting the ruling against it in 2015. Having noted successful settlement of bilateral trade dispute, some Japanese firms are suffering from unfair business practices such as violation of intellectual property rights in China[3].

Japanese firms have deployed a China plus one strategy with investment diversification in Southeast Asia in addition to China. This has helped expand East Asian production networks and supply chains. The East Asian grouping consisting of China, ASEAN and the plus 4

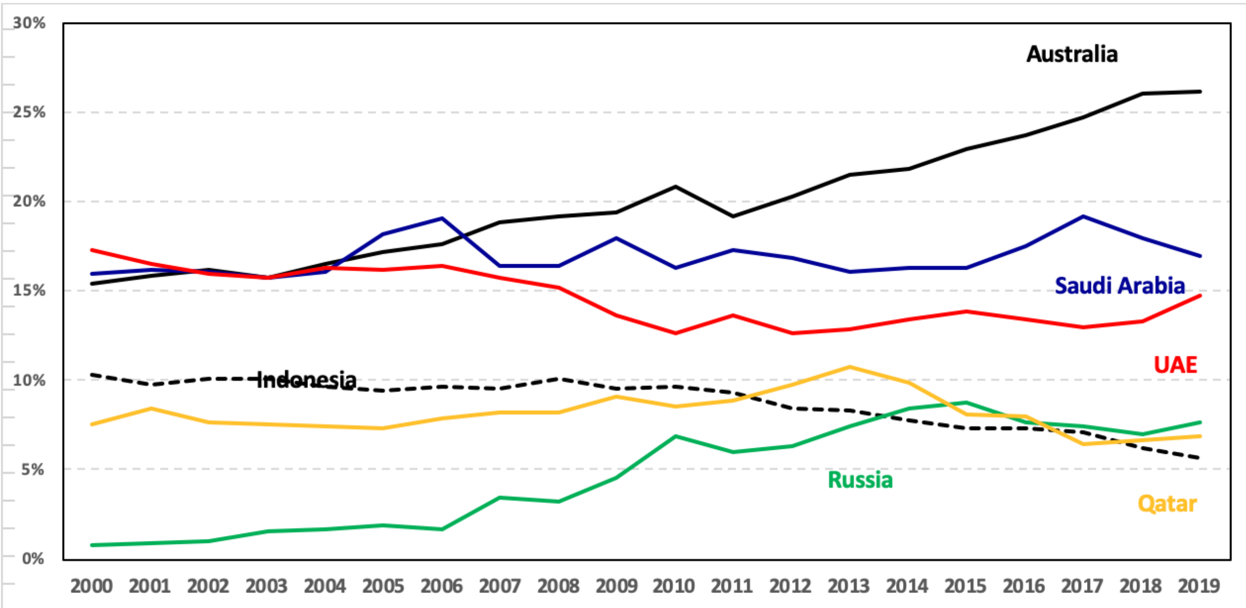
[3] According to a survey conducted by the Japan Bank for International Cooperation, 35.5 percent of the respondents indicated that insufficient protection of intellectual property right is a problem in China. https://www.jbic.go.jp/ja/information/press/press-2019/pdf/1127-012855_4.pdf

countries that are all initial members of the Regional Comprehensive Economic Partnership (RCEP) grouping account for 44 percent of Japan's exports and 47.5 of its imports.

The share of the ASEAN group of countries and the plus 4 (South Korea, Australia, India and New Zealand) in Japan's trade has stayed relatively consistent through 2000 to 2018 (Figures 1 and 2). This underestimates Japan's impact in deepening trade between East Asian countries, driven by Japanese foreign direct investment, and masks some of the significance of the trade relationships.

Australia accounted for only 2.1 percent of Japan's trade in 2018 but is the major source of energy imports and strategic raw materials like iron ore. Japan relies on imports for 90 percent of its energy needs and Australia is the largest supplier, supplying over a quarter of Japan's energy needs (Figure 3). Australia is the largest supplier of coal and LNG for Japan accounting for 71.6 percent of Japan's coal imports and 34.6 percent of Japan's LNG imports[4]. Australia supplies over half of Japan's iron ore imports.

Figure 3 Share of Japan's energy imports, 2000-2019, gigajoules



Source: Calculated based on Trade Statistics of Japan, MOF, Japan; UN Comtrade, UNSD; BP Statistical Review of World Energy, June 2020, BP.

Japan's energy security depends on reliable energy imports from the international market. It was commitment to the open multilateral trading system that helped secure Japanese energy imports, complemented by bilateral and regional agreements that gave confidence in open markets.

The position of Japanese foreign direct investment abroad is in stark contrast to Japan as a host of FDI. Japanese FDI accounted for 5.4 percent of global FDI stock in 2018, up from 4

4 https://www.enecho.meti.go.jp/en/category/brochures/pdf/japan_energy_2019.pdf

per cent in 2000, but Japan only hosted 0.7 per cent of global FDI in 2018, significant given the size of the Japanese economy as the world's third largest. The United States is the largest destination for Japanese FDI with a stock of $533 billion in 2018 compared to $172 billion in the United Kingdom, $133 billion in the Netherlands (as an entrepot for Europe) and $130 billion in China. Japan is the largest non-Chinese source (Taiwan and Hong Kong) of FDI in mainland China. Rising wages in China since the mid-2000s and the uncertainty around the US-China trade war, combined with improvements in business conditions in ASEAN has led to increased Japanese FDI in ASEAN, with ASEAN's share of Japanese FDI increasing. Japanese FDI to China has continued to increase in absolute terms but as a share of total outward Japanese FDI, it has been falling since 2010.

Japanese FDI is global with $506 billion in the European Union, $554 billion in North America and $516 billion in Asia, of a total estimated external FDI position for Japan of $1.86 trillion in 2019[5]. Japan is relatively closed to inward FDI. Among OECD countries Japan has the lowest stock of FDI relative to the size of its GDP.

Japan has managed its large trade and investment relationships — including securing energy and strategic raw material imports — under the framework of the multilateral trading system. It has managed its largest economic relationships without bilateral free trade or economic partnership agreements until only very recently. The bilateral agreements that Japan has secured have been complementary to, not substitutes of, the WTO and multilateral rules. It's that multilateral system which is weakening and under threat.

Uncertainty and Japan's international economic diplomacy

There are five related major trends that are creating unprecedented challenges for countries like Japan. First is the rapid economic rise of China, and the accompanying growth in Chinese political and military power. Second, the United States is in retreat from global leadership of multilateral institutions and economic governance, and pursuing an 'America First' agenda. Third, China and the United States are locked in strategic competition, including a trade war that has only seen a temporary truce in a phase 1 trade deal. Fourth, new technologies centred on cyber and digital are changing how economies engage and without agreed multilateral rules are introducing new vulnerabilities and fault lines between countries. Finally, the COVID-19 pandemic accelerated those trends with the major health crisis and an economic downturn not seen since the Great Depression of the 1930s. The health and economic fallout from the pandemic has not led to cooperation between the United States and China, but has intensified it.

These challenges are particularly acute for Japan given its position between the United States and China, as the third largest economy in the world and relying on the US security umbrella

[5] JETRO https://www.jetro.go.jp/en/reports/statistics.html

and economy with China as its largest trading partner and close neighbour with which it has disputed territory. Having indicated the important and difficult relations with the United States and China, it should be noted that Japan has relied on the open, rules-based multilateral trading system for its economic development and to secure its economic interests with both China and the United States, as well as the rest of the world.

America first, trade wars and uncertainty

US President Donald Trump introduced significant uncertainty for the global economy and dramatically changed the circumstances for countries like Japan. Trump's leadership may be a particularly brazen and sharp form of US leadership that cast doubt on Japan's US security umbrella when he was first elected, but his approach to trade and multilateralism can be explained as being a symptom of underlying domestic challenges in the United States, instead of President Trump being a cause. The approach to trade with allies and competitors alike caused great uncertainty, the shift in relative power between China and the United States, and the rise in protectionism in the United States due to the maldistribution of income and wealth.

Japan's response to these new uncertainties in its external environment was to shift from passive to proactive external policies to protect and shape the multilateral trading system (Urata, 2020). Prime Minister Shinzo Abe's active diplomacy and coalition building from the beginning of his return to the prime ministership in 2012 set the groundwork for a leadership role in international economic policy that became seen as necessary with the election of Donald Trump as US president in 2016. One of President Trump's first actions was to withdraw the United States from the Trans-Pacific Partnership in January 2017, which had been concluded in late 2015 but had not entered into force.

The TPP served multiple purposes for its members. In political-security terms, Australia, Japan and other US allies and partners saw the TPP as a way to keep the United States engaged in the Western Pacific. The United States had framed the TPP as the economic arm of its pivot to Asia. In economic terms, the TPP was pushing rule-making and liberalisation where bilateral agreements were delivering diminished returns and multilateral rule-making and liberalisation had become difficult and stalled.

The TPP did have its problems and challenges, including gaps in its membership, with just over half of the 21 APEC members, for example, without China, Indonesia, South Korea and other major economies. It had the perception of being US-led because of the rhetoric and structure of negotiations, and had a set of liberalisation and rule-making demands from the United States that were difficult for negotiating parties to commit to. Many governments expended vast amounts of political capital in agreeing to the high standards of deep liberalisation and new rules, including those demanded by the United States. At times was framed as an agreement that was aimed at containing China's economic rise at worst, and shaping the rules and standards for China to conform to at best.

For Japan, the TPP was a key pillar of the structural reform arrow of the Abenomics growth strategy, both symbolically and for what it would achieve as a beachhead in liberalising the agriculture sector (Solis, 2017 and Solis and Urata, 2018).

The US withdrawal from the TPP created great uncertainty for the remaining members but also for the global trading system as it was only one of the promises of Trump from the election campaign. The campaign included threats of high tariffs on Chinese and Mexican imports as well America First rhetoric that signaled retreat from multilateralism and global leadership in trade (Productivity Commission, 2017). With uncertainty about whether the US Congress and Washington establishment would constrain the Trump Administration from its more extreme threats on trade and alliance management, Japan led the conclusion of the Comprehensive and Progressive Agreement for the TPP (CPTPP) with the remaining 11 members. Australia, New Zealand and Singapore were key partners in pushing for its conclusion but it was the economic weight of Japan and its leadership that made the difference (Terada, 2019). The CPTPP keeps open the option of eventual US membership in the original TPP, as unlikely as that is in the near future, and maintains almost all of the original TPP commitments.

President Trump's election promises were gradually realised throughout 2017, and accelerated in 2018 as it became clear the extremes of his administration were not going to be reigned in by the US Congress or other interest groups. Japan was president of the G20 group and its presidency saw the accelerating of the tit-for-tat trade war between China and the United States. Given intensified rivalry between the United States and China, the Osaka G20 summit in June 2019 was held successfully as a leaders' statement with several important messages was delivered. The APEC summit in Papua New Guinea in 2018 had failed to produce a leaders' communique for the first time primarily because of the Sino-US tensions. Although a strong leaders' statement on multilateralism and avoiding trade protectionism were absent, it included two most important issues that Japan fought hard: promotion of digital economy under the "data free flow with trust (DFFT)" initiative, and construction of "high-quality infrastructure".

The trade war between Japan's two largest trading partners and the world's two largest economies proceeded in fits and starts throughout 2018 and 2019. The Phase One trade deal reached between the two countries brought a truce to the trade war with agreement for China to purchase US $200 billion of agricultural goods and energy from the United States over 2 years. The agreement that was primarily about the volume of US imports that China committed to, moved the trading relationship between the world's largest economies and traders towards managed trade, outside of the existing rules and norms of the WTO. The implications for energy and agriculture importers like Japan were significant, as they were for producers and exporters like Australia.

Under pressure from the United States, Japan had agreed to purchase corn and other US agricultural produce to reduce the bilateral trade imbalance between the two. Japan had resisted a bilateral deal with the United States, preferring to try to bring them back to the TPP but eventually acquiesced and agreed to the US-Japan Trade Agreement, largely because of a threat from the United States that it was considering the imposition of high tariffs on automobile imports from Japan. Japan was far from alone as other countries, like South Korea, Canada and Mexico, worked to negotiate deals including voluntary export restraints and other measures like the ‘poison pill’ provision in USMCA (that would allow the US to hold the deal hostage to Canada or Mexico negotiating with China) to avoid US tariffs. Those measures were also outside the existing multilateral rules, and some like VERs had been ended when the Uruguay Round had been completed. Other countries like Australia negotiated exemptions from US steel and aluminium tariffs, agreeing to VERs.

Repairing the China relationship

The China-Japan relationship had been gradually improving from the middle of the decade following a low point in 2012, prior to Abe and President Xi coming to power within the span of four months. The large and complementary economic relationship between China and Japan had kept the political relationship from deteriorating too much (Armstrong, 2012) and the underlying economic interdependence was a powerful incentive to better manage the political relationship.

Prime Minister Abe’s state visit to Beijing in October 2018, his first bilateral visit (Abe had visited China for APEC in 2014 and the G20 in 2016) since he made the historic ‘ice-breaking’ visit in 2006 in his first trip abroad as prime minister. In that October 2018 trip, China and Japan agreed to 52 joint infrastructure projects in third country markets, elevating cooperation in a potentially important area that had been difficult to find common ground on as competitors in infrastructure investment in Asia. The joint infrastructure projects were not agreed under the umbrella of China’s Belt and Road Initiative (BRI) but potentially plays a significant role in shaping the BRI (Armstrong, 2018). Japan had not signed an MOU with China to join the BRI, and other G7 countries, especially in the Asia Pacific, found it difficult to engage with China’s BRI. Italy was the first G7 country to sign an MOU to cooperate with China on BRI in 2019. Japanese policy initiative had managed to find a way to work with China on a policy priority for both countries and to influence Chinese policy development through engagement. The theatre of infrastructure investment in developing countries and improving connectivity with China was seen as a threat to the existing US-led order by many in the West[6].

Chinese agreement to joint infrastructure projects with Japan, including state participation in projects, meant that those projects that were largely in Southeast Asia would not proceed without agreement on standards, largely set by Japan. This demonstrates an interest from (or faction of) Chinese authorities to improve standards in their investment projects that had seen some commercial failures and spectacular international political backlash. What’s more, China adopted the same language and principles as the Japanese-led Ise-Shima Principles for Promoting Quality infrastructure Investment in its BRI Summit in 2019. For Japan, it was a positive initiative that would further a common interest with China that would help improve

[6] See, for example, Macaes (2018) for discussion of the views.

the bilateral relationship, without compromising on any interests. The MOU that was signed mirrored the language Japan had used in an MOU on joint infrastructure projects with the United States and Australia only months before. Japanese experience of failed projects and geopolitical pushback from its forays into infrastructure investment in Southeast Asia in the 1980s gave Japanese policymakers an understanding of the economic and political challenges currently faced by China.

In managing the relationship with an increasingly unpredictable Trump Administration and the increasingly assertive Xi Xinping, Prime Minister Abe and Japan found itself in an unusual leadership position. As a US ally Japan had relied on US leadership — as had much of the rest of the world — in regional and global economic initiatives. Even major reforms were largely driven by US pressure, or *gaiatsu*, including the perception of agricultural reform in the TPP negotiations. After successfully leading the conclusion of the CPTPP, the Japan-European Union economic partnership agreement was concluded and brought into force in February 2019. That was at the time the largest bilateral economic agreement globally. Japan had also elevated the priority of the Regional Comprehensive Economic Partnership (RCEP) agreement between the 10 member Association of Southeast Asian Nations (ASEAN), Australia, China, India, Japan, Korea and New Zealand, by hosting, in July 2018, the first ministerial meeting outside of ASEAN where the agreement had been conceived. Japan had become the de facto leader of multilateralism.

Regional leadership and its challenges

Prime Minister Abe had invested political capital in building a strong personal relationship with President Trump and had managed the economic and security relationship with the United States while gradually improving the bilateral political relationship with China. Japan had also strengthened political relations with other countries with active diplomacy. That included Australia, Southeast Asia, Canada, Europe and the Middle East. There was mixed success in some key relationships with efforts to structurally improve relations with Russia by resolving territorial disputes having failed and the bilateral relationship with South Korea gradually deteriorating.

Japan was G20 president in 2019 and navigating the China-US trade tensions in the Osaka G20 Summit while protecting the multilateral system was the top strategic priority, as Prime Minister Abe outlined at the World Economic Forum in Davos earlier in 2019. The Osaka Summit failed to produce any significant breakthrough but the leaders' statement did include defense of the multilateral trading system. The expectations for the summit were not high given the China-US trade war and erratic US president.

On the sidelines of the G20 Summit Japan launched its Data Free Flow with Trust (DFFT) initiative that aims to set governance standards in digital and cyber, an area where global rules and norms do not yet exist but plays an important role in the determination of the competitiveness of the countries and firms.

After the successful conclusion of the Osaka Summit meeting in June, Japan's tensions with South Korea spilled over into a Japanese export restriction of chemicals and other strategic materials that coincided with Japanese anger at a Korean Supreme Court decision to overturn a key agreement that was the basis for the 1965 treaty between the two nations. The timing of the decision appeared politically driven and both President Moon and Prime Minister Abe used the spat for domestic political gain and the Japan-South Korea relationship deteriorated to a low point since normalisation of diplomatic relations in 1965.

It was also in October 2019 that Japan gave in to US pressure and signed the US-Japan Trade Agreement which Japan had resisted negotiating since president Trump had become president. That agreement was outside of the existing multilateral rules and norms, although Japan was not alone in signing defensive agreements with the United States. Japan had avoided the 'poison pill' provision that the United States had included in the USMCA given the importance of the China relationship to Japan. In the US-Japan Trade Agreement the United States more or less recovered what it lost in beef and pork market access concessions from Japan by withdrawing from the TPP, while Japan did not achieve the automobile market access concessions it had won from the United States in the TPP negotiations. These developments concerning its trade relationship with the United States indicate the difficulty in protecting the multilateral trading system by Japan.

The new economic security posture

There does not appear to be any clear and accepted definition of economic security in Japan. With increased uncertainty internationally complicating Japan's economic, foreign and security policies, there has been a deliberate effort to break down silos in Japanese policy making and thinking. Economic security can have different meaning in economic or security agencies.

Coinciding with the election of President Trump and the America First agenda, there has been a focus on 'economic security'. That traditionally meant ensuring national security through economic means and referred to energy, resources and food. A group of ruling Liberal Democratic Party (LDP) legislators led by Akira Amari, a senior LDP member and former Minister for Economy, Trade and Industry, to propose the establishment of a council tasked with economic security in March 2019.

The genesis of the 'economic security' concept can be traced back in the early 1980s, right after Japan was hit by the oil shocks. The late Masataka Kosaka of Kyoto University proposed the term economic security (*keizai teki anzen hosho*) as part of comprehensive security (*sogo anzen hosho*), which was a key strategic policy framing of the Ohira government[7]. At that time, Japan's focus on economic security was three-fold: 1) preserving

[7] Sogo Anzen Hosho Kenkyu Group Hokokusho [Report of Study Group on Comprehensive Security] https://worldjpn.grips.ac.jp/documents/texts/JPSC/19800702.O1J.html (accessed on 28 November 2020)

the free trade system and solving the North-South problem, 2) ameliorating diplomatic tensions with some key trading partners, and 3) maintaining energy and food security.

The idea of economic security differs from the idea of economic diplomacy, used by the Ministry of Foreign Affairs since 2006 or so, that was primarily concerned with protecting and developing global economic rules in Japan's national interest. That was pursued primarily through economic partnership agreements (EPAs).

The term 'economic security' can be found in *Diplomatic Bluebook* — for instance in Chapter 3 (b) of the 2007 edition[8] or in Chapter 3 Section 3 (d) in the 2008 edition[9] referring to energy and food security. The section on 'economic diplomacy' became a full section from the 2011 edition[10]. From 2017, MOFA (edited chiefly by the Economic Affairs Bureau) started publishing 'Japan's economic diplomacy' (*waga kuni no keizai gaikou*), in addition to its annual *Diplomatic Bluebook*. According to MOFA's definition, Japan's economic diplomacy should focus on three aspects: 1) rule-making to bolster free and open global economic systems, 2) supporting the overseas business expansion of Japanese companies through promotion of public-private partnerships, and 3) promoting resource diplomacy along with direct investment toward Japan.

Economic security is often understood to overlap with economic statecraft with 'the use of economic means to pursue foreign policy goals' (Baldwin, 1985). Foreign aid, trade, and policies governing the international flow of capital can be used as foreign policy tools in pursuit of national security objectives and are considered the most common forms of economic statecraft. Policies governing the international movement of labour could also be deployed to promote foreign policy goals, but such measures are not usually included under the rubric of economic statecraft.

The recognition of China and the United States deploying economic policies and instruments for security purposes has led to many countries, including Japan, trying to understand the consequences and develop policy responses. The new entanglement of economics and security has meant that policy silos in economics and security have had to be brought together or integrated in some manner.

Bringing economics and security together in machinery of government

Since 2019 there have been deliberate efforts to bring together economic and national security issues and thinking in the Japanese bureaucracy, first in the Ministry of Economy, Trade and Industry (METI) and then in the Ministry of Foreign Affairs (MOFA). These

[8] https://www.mofa.go.jp/policy/other/bluebook/2007/html/index.html
[9] https://www.mofa.go.jp/policy/other/bluebook/2008/html/index.html
[10] https://www.mofa.go.jp/policy/other/bluebook/2011/index.html

developments were followed by the establishment of an economic team in the National Security Secretariat (NSS) within the Cabinet Secretariat.

On 2 June 2019, METI set up a new Economic Security Division with 15 officials, led by the Director General of the Trade and Economic Cooperation Bureau. The Director of the division also serves as the Director of Security Trade Control Policy Division. METI also set up a Rule Making Strategy Division, led by the Director General of the Trade Policy Bureau in July 2014.

In MOFA the Economic Security Division within the Economic Affairs Bureau has traditionally been in charge of energy, resources and food security. In October 2019, National Security Policy Division under Foreign Policy Bureau reorganised its three sub-divisions: Emerging Security Challenges Division, Space and Maritime Security Policy Division and International Peace and Security Cooperation Division.

An economic security division was established in the National Security Secretariat (NSS) in April 2020[11]. One of the factors that led to the establishment of the economic team was the realization by METI of the need to take necessary steps to tighten export controls of advanced technology by responding to the similar policy adopted by the United States in 2018[12]. METI was sensitive to the US policy on export controls since its bitter experiences in the case of Toshiba's violation of the US Coordinating Committee for Multilateral Export Controls (COCOM) for in 1987[13].

METI tightened the regulation on inward FDI with the Foreign Exchange and Foreign Trade Act (FEFTA). The Ministry of Finance that administers the FEFTA could not evaluate technologies from a national security perspective. The expertise and monitoring of different types of technologies falls under the jurisdiction of different ministries. For example, information technology falls under the jurisdiction of the Ministry of Internal Affairs and Communication, while medical and pharmaceutical technologies are the responsibility of the Ministry of Health, Labour and Welfare. The lack of coordination and the compartmentalization of overlapping responsibilities led to the creation of the economic security division in the NSS that can oversee economic security across government ministries and agencies.

The ruling LDP Diet Members' Caucus on Strategic Rule Formulation headed by Akira Amari played an important role in the establishment of the economic team in the NSS. That caucus presented recommendations to the government to set up a National Economic Council

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[11] NSC was created in December 2013

[12] Nobukatsu Kanehara, former deputy director for the NSC, quoted in an article in Yomiuri Shimbun, May 20, 2020

[13] Toshiba and Kongsberg, state-owned Norwegian enterprise, sold $17 million worth of computer-controlled machine tools to the Soviet Union in a period from 1981 through 1984, in violation of the Coordinating Committee for Multilateral Export Controls (COCOM), which was established during the Cold War to put an embargo on Western exports to East Bloc countries. The US administration and Congress protested strongly against this case. On this incident, see, for example, GlobalSecurity.org https://www.globalsecurity.org/intell/world/russia/toshiba.htm

(NEC) modeled after the National Economic Council of the United States, which would play the role of conning-tower for strategic foreign economic policy[14]. According to Amari, Japan did not recognize the concept of economic security, while China uses economic means strategically to favourably alter the policies of other countries.

The economic security division in NSS is one of seven divisions[15]. It is headed by a former Director-General from METI and consists of roughly 20 staff with four councilors, each from the Ministry of Finance, Foreign Affairs, Internal Affairs and Communication, and National Police Agency[16]. The economic security division deals with the protection of technology (export control and regulation of inward foreign direct investment), cyber security (5G, government-private sector co-ownership of information), international cooperation (Japan-US security cooperation, digitalization of Japanese yen), coping with the novel coronavirus pandemic (quarantine policy, strengthening of supply-chains for medical and health equipment) and others. One of the goals of Japan's economic security policy is to prevent the outflow of 'critical technology'[17].

The types of technology that are likely to be targeted for acquisition by non-allied countries include artificial intelligence and 5G communication technology, core technology for the development of a digital economy, as well as robotics and bio-technology[18]. Several methods have been identified to achieve these objectives. One is acquisition of Japanese companies owning technology through foreign direct investment. To deal with this possibility, the Japanese government revised the FEFTA, which is discussed below. Another is cyber theft of technologies from government agencies and private companies. There is also concern of collaborative research with Chinese universities and research institutes. The concern is that advanced technologies would be acquired from Japan by Chinese researchers connected to the Chinese military and used for military purposes. The Japanese government is planning to enforce the disclosure of the sources of the funds of joint research projects that are supported by the Japanese government[19]. The Ministry of Education, Culture, Sports, Science and Technology (MEXT) is the major source of research funding of university and research institutes, and is planning to set up an economic security section to oversee the use of those funds in a manner that ensures 'economic security'[20].

China is one of the largest sources of patents globally and a major source of innovation. How Japan and other advanced economies where some joint research is being seen as a security threat manage collaboration with Chinese universities and researchers is an important question for remaining at the technological frontier going forward.

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[14] Akira Amari, quoted in an article in Yomiuri Shimbun, May 17, 2020.

[15] Others include the coordination team, the strategic planning team, the intelligence team and three teams handing regional affairs.

[16] Nihon Keizai Shimbun, June 3, 2020.

[17] Minute of a committee under the Industrial Structure Council [Sangyou Kouzou Shingikai] (October 2019)

[18] Nikkei Shimbun, June 4, 2020

[19] Nikkei Shimbun, June 24, 2020.

[20] Yomiuri Shimbun, August 24, 2020.

The issues of restricting exports of dual use technology, theft of sensitive technologies and the protection of other cyber assets are not unique to Japan. Pressure from the United States on its allies like Japan is increasing to enact extreme measures. Japan has an interest in finding a way to avoid the US extreme of technological decoupling so that a middle ground of still benefiting from Chinese innovation and technology while protecting Japanese sensitive technologies.

The economic security division in the NSS is expected to work with different agencies across the Japanese government to break up the compartmentalized system and have a consistent strategy. Having a centralised economic security division rather than numerous agencies dealing with economic security issues facilitates cooperation with foreign countries, especially the United States[21]. The economic security division has spent its first four months in existence working intensively on the novel coronavirus pandemic. Faced with growing economic frictions, particularly between the US and China, the coronavirus pandemic, rapid advancement in digital technology and other developments, the economic security division is likely to require expansion to undertake the assigned tasks[22].

Revision of the Foreign Exchange and Foreign Trade Act (FEFTA)

As part of its new economic security posture Japan has tightened the restrictions on inward FDI to prevent foreign investors from acquiring advanced technology from Japanese companies. The Japanese government revised the Foreign Exchange and Foreign Trade Act (FEFTA) with the objective of promoting inward foreign investment that would contribute to Japan's economic growth while restricting inward FDI that may undermine or damage national security. One of the reasons for the revision — which passed the National Diet in November 2019 and enacted in May 2020 — was to follow other advanced countries such as the United States and the European Union, which adopted new regulation on inward foreign investment to strengthen the screening process from the national security viewpoint[23]. Australia has similarly tightened its regulations around inward FDI in the name of national security in 2020, continuing a trend underway in Australia and other western countries. The revised FEFTA introduced a new exemption scheme regarding the pre-notification by foreign investors to the Japanese government and revised the list of industries subject to the exemption[24]. Japan has been relatively closed to foreign investment (see discussion above) and the tightening of FDI for security purposes will likely not help realise more FDI, even with many other advanced economies similarly tightening regulation of FDI.

[21] Yomiuri Shimbun, May 16, 2020.
[22] "Tokyo expands National Security Council to catch economic risks," Nikkei Asian Review, March 16, 2020.
[23] Ministry of Finance, "Rules and regulations of the Foreign Exchange and Foreign Trade Act", https://www.mof.go.jp/english/international_policy/fdi/kanrenshiryou01_20200424.pdf
[24] Ministry of Finance, October 21, 2019 https://www.mof.go.jp/english/international_policy/fdi/20191021.html

Prior to the revision, a foreign investor was required to notify the government of its investment if it was acquiring an ownership share of 10 per cent or greater of a listed company in the designated business sector. The designated sectors, which include weapons, aircrafts, nuclear facilities, space, dual-use technologies, cybersecurity, telecommunications, and others, consist of 155 out of 1,465 sectors, using the sector classification of Japan's Standard Industrial Classification.

In the revision, the exemption scheme of prior notification for stock purchases of the companies in the designated sectors by a foreign entity was introduced with certain conditions. The threshold for prior notification for purchasing stocks has been lowered from 10 percent to 1 percent. Foreign financial institutions are given blanket exemption, foreign sovereign wealth funds, public pensions and other 'general investors' are granted regular exemption, while investors with a record of sanctions or that are state-owned enterprises are not granted exemption[25]. For general investors, acquiring stock of listed companies in designated sectors, prior-notification is exempted with the compliance of the following conditions:

a. Investors of their closely-related persons will not become board members of the investee company.
b. Investors will not propose to the general shareholders' meeting transfer or disposition of investee company's business activities in the designated business sectors.
c. Investors will not access non-public information about the investee company's technology in relation with business in the designated business sectors.

For general investors acquiring 10 percent or less of the stock of the listed companies in the core designated business sectors, prior-notification is exempted with the compliance of the following conditions in addition to the conditions for the investment in the designated sectors, which were listed above;

d. Regarding business activities in core sectors, investors will not attend the investee companies' executive board or committees that make important decisions in these activities.
e. Regarding business activities in core sectors, investors will not make proposals, in a written form, to the executive board of the investee companies or board members requiring their responses and/or actions by certain deadlines.

[25] The discussions here apply to general investors including sovereign wealth funds (SWFs) and public pension funds. The revised law introduced three different treatments regarding the exemption schemes: a blanket exemption; regular exemption; and no exemption, depending on the types of investors. Blanket exemption is applied to foreign financial institutions, while regular exemption is applied to general investors. For investors with a record of sanctions due to the violation of the FEFTA and state-owned enterprises except those who are accredited by the authorities, exemption is not applied. For the details, see "Rules and regulations of the Foreign Exchange and Foreign Trade Act, Ministry of Finance.
https://www.mof.go.jp/english/international_policy/fdi/kanrenshiryou01_20200424.pdf

There are twelve core designated business sectors, which are a subset of the designated sectors including all of weapons, aircrafts, nuclear facilities and other designated sectors, and parts of cybersecurity, telecommunications and other designated sectors.

Those investors that used the exemption scheme are required to submit the post-investment report within 45 days from the transaction settlement data.

The new 1 percent threshold for prior-notification in the revised FEFTA is low compared to other advanced countries except the United States where no threshold is applied[26]. Australia has moved to a zero dollar threshold during the coronavirus pandemic, reduced from a complex and preferential set of thresholds that ranged from zero for some sensitive sectors (all investment proposals screened), to a range of thresholds with higher thresholds of up to AU$1.154 billion for preferential trade or economic partnership agreement partners (no screening for investments below that threshold). The thresholds applied in the cases of France, Germany, and Italy are 33.3 percent, 10 percent, and 3 percent, respectively.

The Ministry of Finance released the information on the list of the companies for which the purchase of stocks by foreign investors is subject to prior-notification on May 8, 2020[27]. The ministry listed 2,102 companies in the designated sectors out of 3,800 listed companies, and 518 companies in the core designated sectors out of 2,102 companies in the designated sectors[28]. These data show that 56 percent of listed companies are subject to prior-notification. There is a criticism about the lack of clarity/transparency in the determination of the companies in the list, calling for clear explanation of the criteria and/or reasons for the selection[29]. Prior-notification began to be implemented on June 7, 2020.

Several concerns have been raised about negative impacts of the revised FEFTA[30]. One is that for a large number of companies — 56 percent of the listed companies are classified under the designated sectors — the purchase of stocks by foreign investors needs prior-notification. According to Nihon Keizai Shimbun, this kind of wide coverage for prior-notification is unusual globally[31]. Although an exemption is possible, the increased coverage of prior-notification is likely to discourage investment by foreign investors. Pesek (2019) noted that with the revised act Tokyo would surely lose any chance it had to re-establish itself as a global financial center. There is also the problem of administering a complex system that requires screening of so many financial transactions. Unlike the presence of a permanent agency like the Committee on Foreign Investment in the United States, in the case of Japan,

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[26] Ministry of Finance, On Proposed Revised Law of a part of the Foreign Exchange and Foreign Trade Act [Gaikoku Kawase oyobi Gaikoku Boueki Ho no ichibuwo kaiseisuru Horitsu an ni tsuite] https://www.mof.go.jp/international_policy/gaitame_kawase/press_release/kanrenshiryou_191018.pdf

[27] Ministry of Finance, List of listed companies subject to prior-notification under the Foreign Exchange and Foreign Trade Law [Honpo Jojo Kigyo no Gaitame Ho niokeru Tainai Chokusetsu Toushi-tou Jizen Todokeide Gaitousei List] https://www.mof.go.jp/international_policy/gaitame_kawase/fdi/

[28] On June 5, 2020 the Ministry of Finance announced that 51 companies are added to and 11 companies are removed from the list of in the core designated sectors, thus totaling 558 companies in the list.

[29] Nihon Keizai Shimbun, June 5, 2020.

[30] Nihon Keizai Shimbun, May 23, 2020, May 31. 2020.

[31] Nihon Keizai Shimbun, May 23, 2020.

evaluation and screening of the cases is undertaken by the Ministry of Finance and other concerned ministries, where the staff in charge are likely to be rotated every three to four years. As such, consistent and reliable screening may be difficult. Another serious concern is that tighter restriction on inward FDI may reduce the pressure on the companies for necessary reform by discouraging activist investors[32]. Reduction in such pressure would result in increased inefficiency or decline in productivity.

Export controls and their politicisation

METI and more recently the economic security division of the NSS oversee export controls of advanced technologies that could end up in a country or actor under sanctions from Japan or the United States, or that can be used to undermine Japan's security[33]. There is the memory of Toshiba being fined for sales to the Soviet Union in the early 1980s for violation of the US Coordinating Committee for Multilateral Export Controls (COCOM) but more importantly there is a concern of advanced technology ending up in North Korea or in the Chinese military. There are also fears of being caught in US-China technological competition and technological decoupling.

Japan removed South Korea from its 'white list' of preferred countries it can export high-tech materials to without licencing in August 2019 for fear that the final end use of some of those materials are not adequately monitored[34]. This placed a new and additional burden on South Korean firms that rely on imports of those materials. This introduced significant uncertainty for South Korean multinationals, including whether they could secure credit in Japan, and uncertainty for smaller South Korean firms as to whether they could navigate the new licencing requirements without import disruptions.

The commercial and economic implications are significant. The tightened export controls of the three high-tech materials fluorinated polyimide, photoresist and hydrogen fluoride are key inputs for the South Korean production of memory chips (for which it is the largest producer in the world) and LCD and OLED displays. Japan is the major supplier to South Korea of these materials, accounting for 94 percent of South Korean imports of fluorinated polyimide, 92 per cent of fluorinated polyimide imports and 44 percent of hydrogen fluoride imports[35].

The tightening of export controls was heavily politicised. The timing of the export restrictions tied it to the South Korean Supreme Court decision to allow the seizure of Japanese company assets to compensate victims of Japanese occupation of South Korea during World War II. The ruling was contrary to the 1965 Treaty between Japan and South Korea. The timing and politicisation of the export controls has led the trade dispute to be labeled an economic or

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[32] Nihon Keizai Shimbun, ibid and William Pesek, "Japan should encourage activist investors, not tie them in red tape, " Nikkei Asia Review, February 27, 2020.

[33] The difference between commercial or industrial espionage or protectionist policies should be differentiated from national security risk, although they are often conflated. The national security label can be liberally applied for protectionist and industrial policy purposes.

[34] https://www.meti.go.jp/english/press/2019/0701_001.html

[35] https://wccftech.com/semiconductor-import-south-korea-critical/

trade war that relates to history, economic competition, regional rivalry, disputed territory and existing political tension by some mass media and concerned observers, particularly those from South Korea[36]. The stated justification of the Japanese government was concern of leakage of material to North Korea.

It is unclear what effect the tightening of Japanese export controls will have on South Korean imports of the materials, the commercial fortunes of the Japanese exporters, the international market for those materials or the effect on South Korea's downstream exports of memory chips or displays. There are broader strategic and geopolitical ramifications with Japan-South Korean political and security cooperation deteriorating, and intelligence sharing agreement with the United States at risk of ending.

After several unsuccessful meetings between the Japanese and Korean governments, the Korean government took the case to the Dispute Settlement Mechanism of the WTO in June 2020. The panel was set up to deliberate the case in July.

One year after the imposition of export control by the Japanese government, several notable developments have been observed in trade and investment concerning the three materials in response to export controls by the Japanese government.

Several Korean firms began building facilities to produce these materials, including with assistance from the Korean government. Japanese firms have been trying to maintain their sales in Korea, which is a very important market for many Japanese firms, by adopting basically three approaches. First, some Japanese firms are trying to maintain exports to Korea by using various channels. For example, some Japanese firms began to export photoresist by using a new policy introduced by METI, which allows transactions between specified firms for the maximum of three years without obtaining a permission to export for every transaction each time[37].

Second, several Japanese firms set up plants in Korea. This is an expected response from Japanese firms and this type of investment is similar to the type known as "tariff jumping investment," in economic literature. In this case, exports by Japanese firms are substituted by local production/sales in Korea by Japanese firms.[38]

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[36] On this view from Japan, see, for example, Nihon Keizai Shimbun
https://www.nikkei.com/article/DGXMZO46789890R00C19A7EAF000
See Korea Herald for a Korean view.
http://www.koreaherald.com/view.php?ud=20200625000809

[37] Nikkei Asia, https://asia.nikkei.com/Politics/International-relations/Japan-partially-reverses-curbs-on-tech-materials-exports-to-South-Korea

[38] Nikkei Sangyo Shimbun [Nikkei Business Daily], 24 August, 2020

Third, some Japanese firms began exporting the materials to Korea from their foreign affiliates in other countries. JSR began exporting photoresist from their joint-venture company in Belgium[39].

These developments have important implications on the structure and performance of the semiconductor materials industry in Japan and Korea. Production of these materials in Korea by Korean, Japanese and firms from other countries have increased, while production in Japan has declined or at least has not increased as much as it would without the export control. This type of development accelerates as production capability/capacity in Korea increases, possibly resulting in an improvement in its competitiveness of the semiconductor materials industry in Korea vis-à-vis that in Japan. This kind of consequence, which does not benefit Japan, did not seem to be expected by the Japanese government when it implemented the policy.

The concern in METI appears to have primarily been the lack of capacity in South Korea's ability to monitor or control exports of those materials and stop them from reaching North Korea, for example. In hindsight to address that problem the Japanese government could have worked closely with the Korean government to jointly address the capacity and governance concerns. The politicisation of the issue has helped to increase uncertainty in the trade of those materials between Japan and Korea, with potential spillovers to other sectors in the bilateral trade and economic relationship.

Supply chains and economic security during the coronavirus pandemic

COVID-19 pandemic has exposed the vulnerability of supply chains for the Japanese economy in the initial disruptions to supply of PPE and electronic equipment as many Chinese factories and suppliers went into lockdown to contain the health crisis. Supply chains have contributed to the rapid expansion of Japanese companies, as they enable Japanese companies to achieve fragmented, task-based specialization under the name of just-in-time production. The outbreak of COVID-19 in Wuhan in China was a reminder of how interconnected economies are as the adverse economic impacts from China spread rapidly to Japan and many other countries through the disruption of supply chains. Since the initial disruption, supply chains and markets have responded rapidly, responding to shortages.

A case in point is the Japanese automobile industry, a major pillar of the Japanese economy. When Wuhan went into lockdown in late January, factories supplying auto parts also shut down. The shortfall suspended the operations of Japanese automobile assemblers in China, Japan and other parts of the world. Vehicle production in Japan declined by 10 per cent in February from the same month a year ago. While Chinese manufacturing began to recover in March and April thanks to the successful containment of COVID-19 in China, the virus was

[39] Nikkei Asia, https://asia.nikkei.com/Spotlight/Japan-South-Korea-rift/Samsung-secures-key-chip-supply-in-Belgium-as-Tokyo-curbs-exports

still spreading in Japan. Factories were shut down in Japan because workers had to stay home as the declaration of a state of emergency was declared in April, causing production to drop by approximately 45 per cent in April compared to last year. Production resumed as the state of emergency was lifted in May, sales of automobiles have remained low because of dampened demand, which is mainly due to uncertainty around the continued pandemic and pessimistic future economic prospects.

Disruption of supply chains have caused chaos for consumers and medical staff, as important supply of some personal preventive equipment from China was stopped. A shortage of personal preventive equipment such as facial masks and protective garments, for which Japan depends more than 50 percent of supplies on China, led to a panic as some consumers paid as much as 1,000 yen (9 US dollars) for a mask and some hospitals used plastic bags rather than medical garments for the treatment of the patients.

The immediate response of Japanese firms faced with the supply chain disruption was to run down inventories and procure products from suppliers in Japan and other parts of the world using existing supply chains. Though supply chains made a rather quick recovery, the pandemic is arousing interest in diversifying supply chains among Japanese companies. Japanese companies are shifting their business strategy from just-in-time to just-in-case. One obvious reason for this is increased concern about a prolonged presence of COVID-19 and the possible emergence of new viruses.

Japanese firms that rely heavily on China for the supply of many goods — including electronics, medical equipment and health products have other reasons for diversifying supply chains. The intensifying US-China trade war and technology race as well as concerns such as possible forced technology transfer in China reduce attractiveness of conducting business in China. Diversifying supply chains could involve shortening networks by reducing the number of links in the chain, or by redesigning products to make their components less specific. But these changes are costly, discouraging diversification. Government intervention could add further costs to businesses that are better at calculating and mitigating risks they face and further onshoring could increase the vulnerability of supply chains to shocks[40].

Japan's Ministry of Economy, Trade and Industry (METI) is keen to secure sufficiency in domestic supply and recently introduced a subsidy program to support Japanese companies in their efforts to diversify and strengthen supply chains[41]. The program has two components. One is to promote domestic investment by relocating overseas production bases back to Japan, or reshoring. The other is to construct strong supply chains involving ASEAN member countries to encourage Japanese firms to move or establish their production bases there.

[40] https://www.eastasiaforum.org/2020/06/07/economic-distancing-from-china-and-the-world-would-carry-heavy-costs/
[41] METI, Outline of the Projects under the FY 2020 Supplementary Budget, April 2020 https://www.meti.go.jp/main/yosan/yosan_fy2020/hosei/pdf/hosei_yosan_pr.pdf

These have widely been described as moving Japanese manufacturers out of China and reducing dependence on China as a production base.

The budget allocated to the first and second components are 220 billion yen (US$2 billion) and 23.5 billion yen (US$200 million) respectively. The money can be used to construct buildings, install machinery and conduct feasibility studies. The program covers half to three-quarters of the costs depending on the contents of the project and the size of the firms, with higher subsidy rates for small and medium-sized enterprises (SMEs). For the component to promote reshoring, 57 companies out of 90 applicants were selected in the first tranches in July 2020 to be allocated approximately 57.4 billion yen[42], while for the component to promote to diversify supply chains into ASEAN 30 companies out of 124 applicants were selected in the first tranches in July 2020. As for the types of businesses of the selected companies, a large number are producers of medical and health products and auto and electronic parts.

The incentive created by the subsidy for Japanese companies to onshore projects or move them to Southeast Asia appear to have had some effect but it is not clear whether and how much this program will contribute to the diversification of supply chains of Japanese companies since it is just one of many factors that will influence a company's decision. Firms will also consider the costs and benefits of diversification — including market size, labour cost, quality of infrastructure, trade and investment policy, and political and social stability in potential investment locations.

Many Japanese multinational corporations (MNCs) have been reorganising their supply chains in Asia regardless of the subsidy. Japanese MNCs and the SMEs that agglomerate around them have been restructuring their supply chains in Asia and investments in China over time due to rising labour costs in China (JBIC, 2019). The China plus one strategy of diversifying investment has been common practice for decades. Without further analysis with more data accumulated, it will not be clear how much of an effect this subsidy scheme has had. The risk is that it becomes corporate welfare that does nothing to make supply chains more resilient.

Conclusion

Japan's economic fortunes rely on the open, rules-based multilateral trading system. That commitment to openness and multilateralism has ensured energy and food security for Japan, and is the framework within which Japan has managed its large economic relationships with China, Europe and the United States. That was the case even before Japan's recent bilateral agreements with Europe or the United States, and the CPTPP. All but Japan's Trade

[42] METI, https://www.meti.go.jp/information/publicoffer/saitaku/2020/s200717002.html
JETRO https://www.jetro.go.jp/services/supplychain/kekka-1.html

Agreement with the United States in 2019 were pursued to complement the WTO and built on the multilateral global trading system.

The multilateral system upon which Japanese economic prosperity relies is under direct threat from Japan's security guarantor. The United States has underpinned Japanese and regional security and has played the primary leadership role in the rules-based order. China's rise, the US retreat from global leadership to an America First agenda, the US-China strategic rivalry and the importance of new areas of commerce that are not subject to multilateral rules have combined to create uncertainty for Japanese policymakers as they navigate the uncertain and dynamic external environment.

Japan has shown leadership in the face of a US retreat from multilateralism, leading the conclusion of the world's largest megaregional agreement CPTPP and signing the world's largest 'bilateral' deal with the European Union. Those required political will and proactive diplomacy. Japan is also a key driver of the RCEP agreement that will lock East Asian economies into new rules and new commitments to openness. Japan's economic weight, political stability and proactive diplomacy has meant a more important role for Japan in multilateralism as the US-China relationship deteriorated.

While managing the political relationship with the United States, the Abe administration has pursued a strategy to improve relations with China and actively strengthen security and economic ties globally with a focus on Southeast Asia. The joint Chinese-Japanese infrastructure projects in Southeast Asia have demonstrated openness by Chinese policymakers to working with Japan and conforming to higher standards and transparency while Japanese policymakers have managed to influence China's BRI without becoming a formal member.

Japanese initiatives towards China have been undertaken in the context of managing the political and security relationship with the United States. The MOU between China and Japan on joint infrastructure projects was modelled on the MOU between Australia, Japan and the United States. Japan is not a member of the Chinese-led Asian Infrastructure Investment Bank and only put real political capital behind RCEP once the TPP, and later CPTPP, was concluded.

The unchartered territory of economic policies with security implications given the context of the external environment has led to policy choices and strategies that lie in contradiction to Japan's emphasis and interest on rules, multilateralism and openness, however insignificant the decisions may seem.

The Trump administration forced a Trade Agreement on Japan that is outside of the established rules and moves the Japan-US relationship closer to managed trade. History and politics have become mixed up in the tightening of Japanese restrictions of exports of critical materials to South Korea. These measures have had adverse security and geopolitical implications by further damaging the Japan-South Korea relationship and more explicitly linking economic statecraft to political disputes.

Complex and restrictive measures have been placed on foreign investment in Japan that at best reduce the prospects of Japan as a global financial centre and at worst inhibit productivity enhancing capital, trade links and technology. Restrictions on FDI by other western countries is cited as part of the policy rationale.

The institutional changes in government to respond to the new economic security challenges, especially the new economic security division in the National Security Secretariat, help bring some policy coherence across the Japanese government but there is no clearly articulated framework for balancing economic and security interests in the national interest. There also does not appear to be an accepted definition of 'economic security'. Thus far the tightening of export control regulations and the tightening of FDI regulations are the main outcomes of the new economic security posture. Export controls, which were imposed on South Korea in August 2019, hurt both Japanese and Korean firms. Japanese exporters reduced their export sales, while Korean users of the controlled materials cut down their production. The ultimate outcome of the actions remain unclear in economic or security terms but production of those materials has shifted from Japan to Korea, including Japanese producers setting up subsidiaries in Korea. It is not clear if the Japanese government expected such development, when it implemented export control. The impacts of tightening FDI regulation are too early to be evaluated as the policy was introduced seven months ago in April 2020.It is too early to tell the effect of government subsidies for Japanese multinational corporations to onshore manufacturing or invest in Southeast Asia to make Japanese supply chains more resilient in the midst of the COVID-19 pandemic. They are largely interpreted as an economic security measure to become less dependent on China.

The measures that Japan has implemented in the name of economic security such as export control and revision (more restrictive) of inward FDI policy incur economic costs and are a retreat from openness. They contribute to a loss of dynamism needed to revitalize the Japanese economy with a declining and aging population.

Considering this point, it is important for Japan to maintain and strengthen the rules-based multilateral trade system and have China and the United States engaged in the system, in order for Japan to achieve economic prosperity and contribute to political stability in the region. To deal with national security issues involving China, establishment and management of a mutually beneficial relationship through active dialogue and cooperation such as joint infrastructure projects with China in Asia should continue to be pursued. Japan will need to cooperate with like-minded countries such as Australia, New Zealand, ASEAN and other countries to keep China and the United States engaged in multilateralism.

The entanglement of economic and security for Japan has led to a series of policies that appear to promote national security interests over economic prosperity. Deployed in the name of economic security, they are restricting trade and investment. It is not clear that the policies are consistent with Japan's current external economic position and deep interest in supporting the multilateral system that helps manage that global economic position. Without a clearly defined economic security strategy that has economic prosperity as central to national security, Japan may be forced down a path of restricted or managed trade with non-allies, which will be damaging to Japan’s prosperity.

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