



Competition in New Domains

Japan 's Economic Statecraft

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Introduction

The Kishida Cabinet, established in October 2021, has set *Keizai Anzen Hoshō*² (Economic Security) as an important policy agenda, and on November 19, 2021, it launched the Economic Security Promotion Council to consider policy priorities and created the Preparation Office for Economic Security Legislation to prepare economic security legislation that will likely be approved by the Diet (parliament) in 2022.

The concept of economic security comes from the Suga administration (2020-2021) and is not an original idea of the Kishida administration. It has been discussed little by little for about five years, reflecting changes in the security environment in recent years, especially the rise of China as a global power and its industrial strategy called “Made in China 2025” launched in 2015.

Since the Japanese government has not provided a clear definition of “economic security,” it is arguable whether the concept of “economic security” is synonymous with economic statecraft. A proposal by the Liberal Democratic Party (LDP) titled “Toward the Formulation of an Economic Security Strategy,”³ released on December 16, 2021, provides the background for the government’s economic security policy. It defines economic security as “ensuring Japan’s independence, survival and prosperity from an economic perspective.” Given that “economic statecraft” is generally understood as nations exerting influence over other nations through economic means rather than military pressure to pursue their strategic goals, the Japanese concept of “economic security” seems to overlap with economic statecraft.⁴

On November 26, 2021, the Preparation Office for Economic Security Legislation set out “improvement of autonomy,” “superiority and indispensability,” and “maintaining and strengthening the international order based on basic values and rules” as the three major goals

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² In this paper, “economic security” is used as the translation of “Keizai Anzen Hoshō,” which is a combination of the three words: “Keizai (economy)”, “Anzen (safety)”, and “Hoshō (defense)”. All of these words are derived from Chinese classics, but Keizai came into use to mean “economy” after the Meiji era.

³ Strategic Headquarters on the Creation of a New International Order Policy Research Council, Liberal Democratic Party of Japan, “Recommendations towards Developing Japan’s ‘Economic Security Strategy’,” December 16, 2020, https://jimin.jp-east-2.storage.api.nifcloud.com/pdf/news/policy/201021_1.pdf

⁴ For example, David A. Baldwin defines it as “the use of economic means to pursue foreign policy goals.” See “Politics, Law & Government: International Relations: economic statecraft,” Britannica, <https://www.britannica.com/topic/economic-statecraft>



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of Japan's economic security policy.⁵ At this stage, the economic security bill approved by the Cabinet on February 25, 2022, focuses on four issues: (i) strengthening the supply chain of important goods and raw materials, (ii) ensuring the safety and reliability of core infrastructure, (iii) creating a framework for supporting important technologies in the public and private sectors, and (iv) introducing measures to protect patents related to sensitive technologies.

The boundary of economic security is not very clear. While some of these policies can be understood solely in the context of internal balancing, such as strengthening resilience of domestic infrastructure, external balancing should also be highlighted. This is because policies such as export controls, investment screening,⁶ supply chain resilience, and infrastructure system deployment can be more effective by working closely with the United States.

This paper begins with an overview of the development of Japan's economic security policies and discusses issues around U.S.-Japan cooperation in economic security. In summary, Japan's economic security policy has evolved in response to changes in the threats surrounding Japan. With the rise of China as a global power, it is necessary to expand policy options, and at the same time, U.S.-Japan cooperation is becoming more important than ever. However, U.S.-Japan cooperation requires consideration of the following issues: (i) strengthening the information exchange mechanism between Japan and the United States, (ii) considering a framework for export control among like-minded countries, (iii) responding to human rights issues, (iv) redoubling efforts to gain private sector support, (v) avoiding protectionism, and (vi) avoiding the "Galapagos syndrome."

Development of Economic Security Policy

(1) History of Export Controls

The term "economic security" first appeared in policy documents in the "Basic Policy on Economic and Fiscal Management and Reform 2021" compiled under the Suga administration in June 2021, but economic security is not a new issue and has been implemented for decades, in particular through export control and direct investment regulations.

Regarding export restrictions, Japan has participated in the Coordinating Committee for Multilateral Export Controls (COCOM) since 1952 and has an export license system for certain cargo exports and service transactions. In other words, during the Cold War, the potential threat to Japan was from the communist countries, and Japan worked as a member of

⁵ Office of Economic Security Law, Cabinet Secretariat of Japan, "Expert panel on Economic Security Law," November 26, 2021, https://www.cas.go.jp/jp/seisaku/keizai_anzen_hosyoousei/dai1/siryou3.pdf

⁶ In Japan, "Investment screening" is not a very common phrase. The Japanese government tends to use "*Tainai Chokusetsu Tōshi Kisei*," or "inward direct investment regulation," instead.



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the Western block.

The collapse of the Soviet Union in 1991, followed by the shift from COCOM to the international non-proliferation regime, such as the Wassenaar Arrangement, and the 2001 terrorist attacks in the United States changed the landscape of economic security policy. Since then, potential threats behind economic security policy shifted from communist countries to the threat of international terrorism.

However, the Foreign Exchange and Foreign Trade Act (FEFTA), which is the legal basis for Japan's export controls and investment screening, did not include national security as the purpose of the law in the original text at the time of its enactment. It was in 2004 that "maintaining the peace and security of Japan or the international community" was added to the purpose provisions (Article 1) of FEFTA. FEFTA has undergone 12 amendments as of February 2022, but the 2004 amendment was the only one made as a private member's bill.⁷ The bill gained bipartisan sponsorship⁸ and was reportedly proposed as a response to the threat from North Korea.⁹

In other words, national security was legally recognized as the main objective of FEFTA only after the threat of North Korea emerged, and that also impacted Japan's economic sanctions policy. When North Korea conducted a nuclear test in 2006, in addition to economic sanctions based on a UN Security Council resolution, Japan implemented unilateral economic sanctions for the first time. It completely banned imports from North Korea, banned North Korean officials' entry, and banned North Korean vessels' entry. Furthermore, when North Korea conducted another nuclear test in 2009, Japan completely banned exports from Japan to North Korea as its own measure. Until 2006, Japan's export controls were carried out in accordance with the four international export control regimes (Nuclear Suppliers Group, Australia Group, Missile Technology Control Regime, Wassenaar Arrangement) and other international treaties. North Korea prompted Japan's use of unilateral sanctions for the first time.

(2) History of Inward Direct Investment Regulations

Contrary to Japan's history of export controls, investment screening for national

⁷ A private member's bill is a bill introduced by parliamentary members and not by the cabinet. Given that Japan has adopted the Westminster style legislation, the cabinet has the power to propose bills. In fact, the vast majority of legislation in Japan is introduced by the cabinet and private member's bills are very limited.

⁸ Sponsors were Kenichi Mizuno (LDP), Jin Murai (LDP), Isamu Ueda (Komeito), Yoshio Urushihara (Komeito), Shu Watanabe (Democratic Party), Masaharu Nakagawa (Democratic Party), Jin Matsubara (Democratic Party), and Akira Nagatsuma (Democratic Party).

⁹ See Committee on Financial Affairs, House Representatives of Japan, "Minutes of the 159th Diet," January 28, 2004, <https://kokkai.ndl.go.jp/#/detail?minId=115904376X00220040128&spkNum=127>



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security purposes was developed through liberalizing inward direct investment and had no specific security target in its origin. Since 1950, Japan has required government approval for all inward direct investment under the Foreign Investment Law. But Japan's accession to the OECD in 1964 required the Japanese government to phase out such requirements according to the Code of Liberalization of Capital Movements (OECD Code). In 1979, the system was changed to a prior notification system due to the revision of FEFTA (Article 26, Paragraph 3). Under this system, the government can recommend changing or cancelling the proposed inward direct investment if such proposed investment would compromise national security, create a barrier to the maintenance of public order, or interfere with the preservation of public safety. This mechanism was in accordance with Article 3 of the OECD Code. The consideration of national security was a result of the progress of liberalization in accordance with the OECD Code, rather than through the recognition of specific threats.

In 2007, non-proliferation was officially recognized and added as a part of investment screening through an amendment to the cabinet order regarding inward direct investment. This amendment was designed to ensure alignment between investment screening and export control, and the requirement for prior notification was prescribed based on "products" rather than "business sectors."

(3) Awareness of a New Security Environment and Economic Structures

As mentioned above, the potential threats that shaped Japan's economic security policy have shifted from communist countries to international terrorism and North Korea. More recently, the expansion of China's economic influence and assertive foreign policy have also affected Japan's approach to economic security.

Evidence of this change first appeared in the infrastructure system export policy. The infrastructure system deployment policy originally started under the Democratic Party's administration (2009-2012) and was designed to strengthen the competitiveness of Japan's infrastructure industry.

However, the Belt and Road Initiative (BRI) set up by China's President Xi Jinping in 2013, followed in 2014 by the announcement to establish the Asian Infrastructure Investment Bank (AIIB), required changes in Japan's infrastructure deployment policy. Former Prime Minister Abe introduced the "Quality Infrastructure Partnership" in May 2015, which has become an alternative to the BRI.¹⁰ Furthermore, the Japanese government proposed the

¹⁰ The Japanese government has never stated that "quality infrastructure partnership" is designed to compete with China's BRI or the AIIB. However, it was widely reported that the aim was to effectively counter the BRI and the AIIB. For example, see "Announced infrastructure investment of approx. 13 trillion yen Competing with



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concept of “Free and Open Indo-Pacific” (FOIP) starting in the fall of 2017, and the “Quality Infrastructure Partnership” has been promoted as one of the policies for realizing that concept. At the second U.S.-Japan Economic Dialogue in October 2017, it was agreed that Japan and the United States would cooperate in infrastructure development in third countries.¹¹

Under these circumstances, Japan’s export control and investment screening policies have also changed. Useful policy background can be found in the interim report of the Security and Trade Management Subcommittee of the Industrial Structure Council of the Ministry of Economy, Trade and Industry (METI) released on January 23, 2017 (the METI Subcommittee Report in 2017).¹² This document focuses mainly on inward foreign direct investment regulations, but it illustrates how Japan’s recognition of potential threats has evolved. The METI Subcommittee Report in 2017 lists the following four items as changes in the global security environment and economic structure:

- (a) Increasing importance of civilian technology in the military field.
- (b) Rise of emerging and developing countries in the world economy and acquisition of technological assets through investment in companies in developed countries.
- (c) Changes in the security environment in Asia, such as North Korea’s nuclear and missile development and increasing tensions over sovereignty over the South China Sea.
- (d) The expanding presence of non-state actors, such as the rise of the Islamic State of Iraq and the Levant (ISIL) through the Syrian civil war.

Although the METI Interim Report in 2017 avoids specifying any country, the entire document implies that China is the main concern.

(4) Economic Policy Integrated with Security

Furthermore, on October 8, 2019, METI published another subcommittee report (the METI Subcommittee Report in 2019),¹³ which stated the need for “economic policy integrated

AIB,” *Tereasa news*, May 22, 2015, https://news.tv-asahi.co.jp/news_politics/articles/000050937.html and “Prime Minister aware of AIIB: ‘Do High-quality infrastructure’,” *Nihon Keizai Shimbun*, May 22, 2015, <https://www.nikkei.com/article/DGXLZO87131070S5A520C1EA2000/>

¹¹ Joint Press Release from Vice President Mike Pence and Deputy Prime Minister Taro Aso on the Second Round of the U.S.-Japan Economic Dialogue, October 16, 2017. <https://www.mofa.go.jp/files/000298945.pdf>

¹² Trade Committee of Industrial Structure Council, Ministry of Economy, Trade and Industry of Japan, “Interim report of Subcommittee on Security Export Control Policy,” January 23, 2017, https://www.meti.go.jp/shingikai/sankoshin/tsusho_boeki/anzen_hosho/pdf/20170123001_01.pdf

¹³ Trade Committee of Industrial Structure Council, Ministry of Economy, Trade and Industry of Japan, “Interim report of Subcommittee on Security Export Control Policy,” October 8, 2019, https://www.meti.go.jp/shingikai/sankoshin/tsusho_boeki/anzen_hosho/pdf/20191008001_01.pdf



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with national security policy.” The METI Subcommittee Report in 2019 referred to U.S.-China competition described in the U.S. National Security Strategy of December 2017, and the U.S. government’s response through the National Defense Authorization Act for FY2019, which expanded the defense industry and also referred to policy measures designed to ensure the dominance of U.S. technologies under the Foreign Investment Risk Review Modernization Act (FIRRMA) and Export Control Reform Act (ECRA). Based on these circumstances, the METI Subcommittee Report in 2019 called for an economic policy that is integrated with national security policy. It should be noted that Japan’s National Security Secretariat added an economic security division in April 2020.

(5) Integrated Innovation Strategy 2020

National security then appeared in the “Integrated Innovation Strategy 2020” in July 2020.¹⁴ In Japan, policies to promote innovation have existed and have been regularly updated since the beginning of the Abe administration in 2013. But previous strategies were focused on how to create innovation in strategic areas with limited resources. This “Integrated Innovation Strategy 2020” was very different because it included the security perspective and it put forth a concept of “comprehensive security” by pursuing resilience against various types of threats including natural disasters, infectious diseases, aging infrastructure, international terrorism/crime, and cyberattacks.

This “Integrated Innovation Strategy 2020” proposes four types of policies: (i) assessment of key technology areas contributing to safety and security, (ii) development of technologies in key areas, (iii) prevention of technology leakage, and (iv) promotion of social implementation of technology. This four-pronged approach has remained consistent in subsequent policy documents focused on technology and innovation.

(6) “Basic Policy on Economic and Fiscal Management and Reform 2021”

“Economic security” first appeared in “Basic Policy on Economic and Fiscal Management and Reform 2021,” which was remarkable because this document listed key priority policies of the government that will have an impact on the budget cycle.¹⁵ In other words, economic security had finally become a priority policy of the Cabinet.

This document identified supply chain risk as a threat to people’s lives for the first

¹⁴ “Integrated Innovation Strategy 2020,” Cabinet decision, July 17, 2020, https://www8.cao.go.jp/cstp/togo2020_honbun.pdf

¹⁵ The Koizumi Cabinet introduced this policy document in 2001. Since then, it is customary to include the main policies of the government in this paper, which is approved by the Cabinet in June every year, and it affects the budget assessment by the Ministry of Finance every fall.



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time, apparently due to the vulnerability triggered by Covid-19. This is not the first time, however, that supply chain risk became a political problem. In September 2010, China imposed restrictions on the export of rare earths due to the territorial dispute around the Senkaku Islands, and in response the Japanese government introduced policies to reduce dependence on China, such as rare earth stockpiling and support for the development of alternative materials. However, at this stage, the rare earth problem did not expand to other business sectors that also relied on the Chinese supply chain.

The impact of Covid-19 on the supply chain in the manufacturing industry was broader than in the case of rare earths. According to a survey conducted by the Japan Bank for International Cooperation (JBIC),¹⁶ Japanese companies' production stopped in China due to the lockdown from April to May 2020. The production shutdown then spilled over to ASEAN, which has an integrated supply chain network with China. Concerns about excessive dependence on China in the supply chain emerged due to the fact that most of the Japanese manufacturing industry has manufacturing bases in China, and the serious shortage of masks in Japan following China's introduction of export restrictions on medical supplies in April 2020. When global demand began to recover around the fall of 2020, the shortage of semiconductors became so serious that the Japanese automobile industry was forced to reduce production. In this context, the issue of supply chains has become a major issue in economic security policy and one of the four key issues to be dealt with in the economic security bill.

Key Issues to be Considered in order to Strengthen U.S.-Japan Cooperation

(1) Information Exchange between the United States and Japan

To protect sensitive technology as part of economic security policy, it is important to strengthen coordination among allies. Without coordination, it is difficult to prevent technology leaks, and it is also difficult to properly crack down on complicated cross-border transactions. At the same time, policy coordination will secure a level playing field for industry. From this point of view, it is noteworthy that the revision of FEFTA in 2019 added information exchange with foreign government agencies that regulate inward direct investment. Article 69-4 of the law allows the Japanese authorities to provide information to foreign enforcement authorities and it discharges civil servants from the confidentiality obligation under Article 100 of the National Civil Service Law.¹⁷

¹⁶ Japan Bank for International Cooperation, "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies" December 24, 2021, <https://www.jbic.go.jp/en/information/press/press-2021/1224-015678.html>

¹⁷ Since Article 69-4 is a provision solely related to inward direct investment, it does not apply to export controls. There is no provision equivalent to Section 1713 of FIRRMA in U.S. export regulations. This



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In the meantime, Section 1713 of FIRRMA, which was established in 2018, also has a provision that allows the Committee on Foreign Investment in the United States (CFIUS) to share information with foreign governments. But the scope of information that U.S. and Japanese authorities can provide is different.

First, Article 69-4 limits the recipients of information to foreign investment screening executive agencies, and FIRMMA defines the information recipients as “any foreign governmental entity of a United States ally or partner.” It is largely at the discretion of CFIUS.

Second, the Japanese law limits the scope of information to the extent that such information contributes to its counterpart’s duties. It also requires confirmation of reciprocity, confidentiality, and prohibition of unintended use when providing information. On the other hand, FIRRMA gives a broad authority to CFIUS and “information important to the national security analysis or actions of the Committee” can be provided “only to the extent necessary for national security purposes, and is subject to appropriate confidentiality and classification requirements.” It is necessary to review actual operations, but at least legally, the United States has greater flexibility than Japan.

The first step should be cooperation between the United States and Japan to give Japan the status of “excepted foreign state” under FIRRMA. If Japan is listed as an excepted foreign state, Japanese companies could be exempt from the examination of CFIUS investment screening in some areas expanded by FIRMMA, and the notification requirement will substantially be reduced. Currently, only Five Eyes (United Kingdom, Australia, Canada, and New Zealand) countries are listed as excepted foreign states. The U.S. Treasury Department published a list of factors to be considered in determining excepted foreign states,¹⁸ but it did not provide any official views about why Japan has failed to meet those criteria. One potential answer to this question is Japan’s insufficient confidential information management system given that the list of factors for determination sets out, as one of the criteria, the confidentiality and classification requirements regarding sensitive information shared by the U.S. Government. The Japanese Government should think seriously about this issue given that the status of excepted foreign state would substantially benefit many Japanese companies.

asymmetry looks odd. In reality, it might not be necessary to exchange information subject to confidentiality obligations under the National Civil Service Law given that some international regimes such as the Wassenaar Arrangement include Russia. There is a separate legal mechanism which enables information exchange between law enforcement officers. But given that both export controls and investment screening serve the national security policy, it is difficult to understand this asymmetry.

¹⁸ U.S. Department of Treasury, “FACTORS FOR DETERMINATIONS UNDER § 800.1001(A) / § 802.1001(A)”, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-excepted-foreign-states>



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(2) Call for New Framework among Like-Minded Countries¹⁹

Japan's export controls are based on the four international regimes and international treaties in which Japan participates, and as already mentioned, Japan's unilateral actions have been limited. However, the change in the nature of potential threats requires the reconsideration of this policy framework.

The June 2021 Security Trade Management Subcommittee Interim Report (the METI Subcommittee Report in 2021) explained the problems of existing international regimes: the large number of participating countries often results in very slow processes, and the discretion of each participating country prevents better coordination, e.g., the standards for each country's export license may differ. Based on this observation, the METI Subcommittee Report in 2021 recommended a new framework among a small number of countries that possess technologies and share policy objectives. It also suggested that such a framework could be created for each specific technology.

The international regime will continue to be the cornerstone of Japanese export control policy, but it is not a bad thing for Japan to have a complementary framework with a small number of like-minded countries, as it will increase policy options for Japan. As a result of the 2004 amendment to FEFTA, Japan is now able to create its own export restrictions without international agreement, so the legal hurdle to establish a separate framework with like-minded countries including the United States has been lowered. The United States has also implemented unilateral re-export controls, which are often troublesome to Japanese companies. A new framework with the United States could potentially reduce the risk of re-export controls given that coordinated export controls would be far more effective than U.S. unilateral action even from a U.S. perspective. However, there are many issues when it comes to forming a new framework. In particular, one issue between Japan and the United States will be how to deal with human rights issues.

(3) Human Rights and Economic Security

The United States and Europe have implemented economic sanctions including export controls based on human rights considerations. They have also institutionalized human rights due diligence in corporate activities. Given that the United States launched the "Export Control and Human Rights Initiative" with Australia, Denmark, and Norway, it is inevitable that Japan

¹⁹ This paper does not analyze the Japanese government's economic sanctions over the situation in Ukraine, but the Japanese government's ban on the export of dual-use products such as semiconductors and oil refining equipment obviously deviates from past practices. Until the Ukrainian crisis, the Japanese government had imposed an export ban on specific countries only based on a UN Security Council resolution.



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will face human rights issues in the context of export controls. Under Japan’s current legal framework, it is not clear to what extent human rights issues can be considered for the implementation of export controls. This is because the purpose of export controls is “maintaining international peace and security” (Article 1 of FEFTA), and it does not include the protection of human rights. But there is an argument, according to the METI Subcommittee Report in 2021, that export control authority can enforce laws based on human rights considerations given that Japan’s export controls are created in line with international agreements and some international agreements aim to prevent human rights violations. At this stage, it is METI’s view that the government can consider human rights issues with respect to weapons specifically listed under FEFTA and relevant regulations. However, it is not clear about dual-use products, weapons of mass destruction, and conventional weapons given that international treaties dealing with those goods do not specify human rights protection in their objectives. Moreover, even under this interpretation, surveillance cameras cannot be regulated solely on the ground of human rights violations. Please find below the matrix showing METI’s interpretation of FEFTA (Table 1).

To further complicate matters, there is the precedent of the ban on all-wheel drive vehicle exports to South Africa from 1964 to 1994 as a response to South Africa’s apartheid. According to METI’s interpretation of FEFTA, these types of products should not have been regulated on the basis of human rights violations. While regulations have changed since then, the existence of this precedent makes it difficult to understand how much human rights issues can be considered in export controls in a consistent manner.

Table 1²⁰

Items \ Control perspective		Maintenance of international peace and security (prevention of the occurrence and expansion of conflicts and their serious impact on international security)	
			Consider factors such as human rights, humanitarianism, securing military superiority and strengthening military industry
List of controlled items in FEFTA	Weapons	○	○
	Dual-use products		Not clear
Other than the list of controlled items in FEFTA	WMD · Conventional weapons in Catch-all control	○	Not clear
	Security items (Water cannons, security cameras, etc.)	×	× (However, exceptions have been made in the past)

²⁰ Originally created based on Trade Committee of Industrial Structure Council, Ministry of Economy, Trade and Industry of Japan, “Interim report of Subcommittee on Security Export Control Policy,” June 10, 2021, https://www.meti.go.jp/shingikai/sankoshin/tsusho_boeki/anzen_hosho/pdf/20210610_1.pdf



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On the other hand, the nexus of economic security and human rights is a difficult problem for Japanese companies. Japanese companies are well aware of human rights issues. According to survey results of Japanese companies released by the Ministry of Foreign Affairs and METI in November 2021, about 70 percent of the 760 responding companies have already formulated human rights policies, and 52 percent have implemented human rights due diligence measures.²¹

Japanese companies operating globally have also been making efforts due to the pressure of Environmental, Social, and Governance (ESG) investment, which has had more of an impact than government regulation. It is just impossible, however, to expect Japanese companies to make unlimited efforts to protect human rights under any circumstances. Without a clear legal framework, Japanese companies might be trapped in a “Catch-22” situation. For example, if one country bans exports to another country due to human rights concerns, companies in third countries that continue to do business and export to the “offending” country may find themselves facing backlash and boycotts. However, if companies in third countries stop exports to the “offending” country, they may face retaliation. In this case, a clear legal framework and decision by the third country could help these companies to some extent. At least, no clear legal framework and no clear guidance by the government in the third country looks like the worst policy choice.

Careful consideration should be given to whether to use export controls to deal with human rights issues, but it is not desirable to maintain the typical Japanese process of requesting companies to take voluntary action while leaving the legal basis ambiguous. It will be important to separate the issue of what kind of mechanism Japan should put in place to respond to human rights violations and the issue of whether Japan could implement such a mechanism. Japan should expand its policy options as much as possible under the growing geopolitical uncertainty.

(4) Cooperation with Industry

Economic security is realized by regulating and incentivizing the economic activities of companies, so gaining the understanding of companies is the key to implement economic security policies in an effective manner. It should be noted that information leaks are more likely to be caused by negligence than malicious exporters. Since 2003, the National Police Agency of Japan has published the results of arrests for illegal exports of weapons of mass

²¹ Ministry of Economy, Trade and Industry of Japan, and Ministry of Foreign Affairs of Japan, “Results from the Questionnaire Survey on the Status of Efforts on Human Rights in the Supply Chains of Japanese Companies,” November 30, 2021, <https://www.mofa.go.jp/mofaj/files/100265103.pdf>



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destruction-related goods in the White Paper on Police, but there are only 38 cases of arrests in total up to 2020.²² On the other hand, according to METI, most of the violations of export control regulations were caused by a mistake in judging the necessity of an export license (51 percent), or lack of knowledge of FEFTA (31 percent).²³ Probably the biggest risk to the protection of sensitive technology is the underdeveloped management system of the company and its poor judgment.

With the deterioration of U.S.-China relations, Japanese companies are taking economic security seriously. In a questionnaire survey of 100 Japanese companies released by the Asia Pacific Initiative (API) in December 2021, 62 percent of companies answered that they were strongly aware of economic security, and 86.9 percent of companies answered that they were working on specific measures such as strengthening information management.²⁴

However, this does not mean that Japanese companies are supporting the up-coming economic security legislation. According to a survey conducted by NHK, a Japanese national broadcaster, of 100 major companies, around 60 percent of responding companies suggested that regulations for preventing technology leaks should be carefully promoted while considering the impact on the economic activities of companies.²⁵ The economic security legislation package is not likely to include amendments to export control and inward direct investment restrictions. At this stage, the only policy measure related to technology protection included in recommendations by the Council of Experts on the Economic Security Legislation centers on the non-disclosure of patent information.²⁶

Dialogue with companies is important in making such policy decisions. However, Japanese companies tend to hesitate to talk to the government individually, especially on sensitive topics. Therefore, many companies prefer to make policy recommendations through industry groups such as Japan Business Federation (Keidanren). However, many of Keidanren's member companies are traditional manufacturers, financial institutions and trading houses. And there are not many companies that produce emerging technologies. In particular,

²² National Police Agency of Japan, "The White Paper on Police 2021," (n.d.) <https://www.npa.go.jp/hakusyo/r03/index.html>

²³ Security Export Inspection Office, Trade and Economic Cooperation Bureau, Ministry of Economy, Trade and Industry of Japan, "Analysis of FEFTA Violation Cases," October, 2021. https://www.meti.go.jp/policy/ampo/gaitameho_document/ihanjireigaitamehou2.pdf

²⁴ Asia Pacific Initiative, "Main Survey Results (Key Findings): 100 Companies' Responses to the Economic Security Survey," December 24, 2021, https://apinitiative.org/GaleyudaTuFo/wp-content/uploads/2021/12/API-Economic-Security-Survey-Key-Findings_Dec2021.pdf

²⁵ Nippon Hoso Kyokai, "60 percent of major companies expressed concerns over economic security policies," January 26, 2021, <https://www3.nhk.or.jp/news/html/20220126/k10013449881000.html>

²⁶ It should be noted that the cabinet has broad authority on export control and investment screening rendered under the Foreign Exchange Law. Substantial changes could be possible through Cabinet orders without legislative amendment requiring Diet process.



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IT companies are not interested in joining Keidanren.²⁷ Keidanren has 26 board members, of which around 20 are made up of member companies. But as of March 2022, the only member from a relatively new technology company is Tomoko Namba, chairperson of DeNA, a provider of mobile and online services, which demonstrates the underrepresentation of technology companies in industry groups. In advancing dialogue with companies, the government should consider creating a mechanism that adequately represents the voices of emerging technology companies.

(5) Protectionism and Rent Seeking

Policies implemented in the name of economic security at the beginning might end up protecting domestic industries. To avoid such consequences, it is necessary to design and implement policies so that the government can build trust with a broad range of stakeholders. In this context, the recent example of amendments to Japanese investment screening policy is noteworthy. This is because investment screening can often lead to protectionism, as it may be a hurdle to mergers and acquisitions (M&A) by foreign investors, and stricter investment screening can easily gain domestic political support given that investment screening is predominantly targeting foreign investors.

In 2019, there were some major amendments made to FEFTA in relation to the prior notification requirement. First, the threshold of share percentage triggering prior notification requirements regarding stock purchases of listed companies was reduced from 10 percent to 1 percent. Second, any consent which would have a substantial impact on the investee's operation requires prior notification. Third, the scope of business sectors which require prior notification was substantially expanded to include some IT sectors in view of the risk of cybersecurity. With these amendments in 2019, the scope of prior notification requirements was substantially expanded. This naturally resulted in the increase in the number of prior notifications. According to a report released by the Ministry of Finance in July 2021,²⁸ the number of prior notifications sharply increased in 2019 and 2020 (See Table 2 below). This is due to the expansion of sectors,

²⁷ For example, Rakuten, one of the largest Japanese e-commerce companies, did not join Keidanren and created its own group called "Japan Association of New Economy" in 2010. Tomoko Namba's DeNA joined Keidanren immediately prior to her appointment as a board member of Keidanren. However, it is reported that she had declined Keidanren's invitation for many years because IT companies were underrepresented in Keidanren. Hitoshi Mizuki, "The true intention of Keidanren, which appointed first female vice chairperson," *President Online*, April 1, 2021, <https://president.jp/articles/-/44698>.

²⁸ Foreign Investment Policy and Review Office, Ministry of Finance of Japan, "Number of Prior Notification under Foreign Exchange and Foreign Trade Act (FY2020)," July, 2021, https://www.mof.go.jp/english/policy/international_policy/fdi/Number_of_Prior_Notification_under_FEFTA.pdf



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to include IT industries relevant to cybersecurity. But there were no substantial changes in the number of prior notifications in other sectors.

Table 2²⁹

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Weapons, etc.	127	149	171	233	188	165
Aircrafts	0	6	2	19	23	22
Nuclear facilities	0	0	2	12	10	4
Space	0	2	3	15	16	16
Cybersecurity	-	-	-	-	1,457	1,599
Electricity/ Gas, etc.	285	437	395	318	235	386
Telecommunications	29	17	18	14	-	0
Broadcasting	0	0	2	7	2	11
Water supply	2	2	5	3	6	3
Railway	3	1	1	3	2	1
Public transportation	6	23	9	0	0	0
Biological chemicals/ Pharmaceutical manufacturing, etc.	20	28	14	19	34	76
Security services	47	57	44	40	77	21
Agriculture, Forestry and Fisheries	31	64	76	94	96	53
Oil	56	61	53	49	46	38
Leather manufacture	19	35	31	10	29	2
Air transportation	20	24	33	31	11	7
Martime transportation	21	39	33	36	31	11
Total number of PN	493	665	612	594	1,946	2,171
Sum of the PN by sectors	666	945	892	903	2,263	2,415

Looking at the overall trend of inward direct investment, the amount of inward direct investment on a net basis has been steadily increasing in both 2019 and 2020 (See Chart 1 and Table 3 below). Inward direct investment from the United States, the United Kingdom, and Singapore, traditional sources of direct investment in Japan, were on the rise, and investment from China, Hong Kong, and Taiwan in 2020 was larger than in 2018. The year 2020 may be exceptional due to the surge in stock prices caused by global monetary easing, but the expansion of the scope of notifications did not give rise to an immediate chilling effect on

²⁹ Originally created based on Foreign Investment Policy and Review Office, Ministry of Finance of Japan, "Number of the Prior-notification under the Foreign Exchange and Foreign Trade Act (FY 2020)," July, 2021, https://www.mof.go.jp/english/policy/international_policy/fdi/Number_of_Prior_Notification_under_FEFTA.pdf



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inward direct investment.

Chart 1³⁰

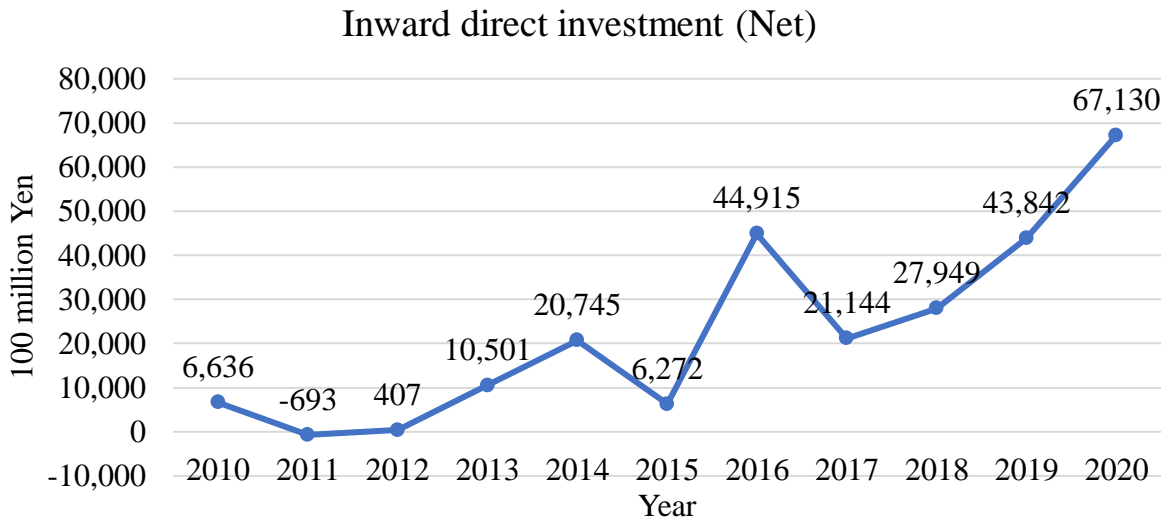


Table 3³¹

	P.R.China	Hong Kong	Taiwan	Singapore	U.S.A.	U.K.
2016	-111	1,614	2,585	4,039	7,477	6,124
2017	1,114	-452	1,006	3,541	6,700	-4,233
2018	886	860	412	-505	7,010	4,849
2019	2,092	2,270	1,115	2,773	18,674	3,054
2020	1,427	1,294	762	5,635	16,978	32,755

The 2019 amendment to FEFTA expanded the scope of advance notification, but it has also introduced exemptions from prior notification in certain cases for the benefit of foreign investors irrelevant to any security concerns. In addition, factors to be considered in examination by Japanese authorities have been announced in both Japanese and English. This well-considered design and transparent implementation have dispelled concerns over creeping protectionism, which is why this is a useful example for other policy measures regarding economic security.

Economic security policy also involves the risk of rent-seeking because it is difficult

³⁰ Originally created based on Ministry of Finance of Japan, "Summary of Direct Investment Liabilities," data of Inward direct investment (year), (n.d.)

https://www.mof.go.jp/policy/international_policy/reference/balance_of_payments/bpfdi.htm

³¹ Originally created based on Ministry of Finance of Japan, "Direct Investment Assets/Liabilities, Country Breakdown," data of Inward direct investment (by region), (n.d.)

https://www.mof.go.jp/policy/international_policy/reference/balance_of_payments/bpfdi.htm



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to prove the efficacy of such policies with quantitative evidence. For example, “food security” has existed long before the term economic security appeared. Since 1995, on the grounds of food security, the Japanese Government has maintained a tariff of 341 yen per kg of rice, which was equivalent to 778 percent when converted to a tax rate. Until 2018, Japan tried to encourage farmers to reduce rice production by paying them a subsidy to switch from rice to other crops because of the consistent decline in rice consumption. It has been argued, however, that this tariff and the subsidy did not contribute to food security, but only benefited an interest group called the Japan Agricultural Cooperative, by maintaining the high price of rice.³² This example shows that any security policy can be a target of persistent rent seekers. In the case of economic security policy, it is likely to cause similar problems given that it requires cooperation with companies. It should also be noted that the political power center has shifted from the ruling party and bureaucrats to the Prime Minister’s Office as a result of the introduction of the political party subsidy system in 1994, the small constituency system in 1996, and the establishment of the Cabinet Personnel Bureau in 2014. It is likely that the approach of rent seekers may have been recalibrated in response to such changes. Since economic security is the Kishida administration’s flagship policy, it is necessary to be aware of the risk that the Prime Minister’s Office itself could be mired in rent seeking.

(6) Avoiding Galapagos Syndrome

Policies overemphasizing the protection of sensitive technologies and the reshoring of important production technologies have the risk of causing the so-called “Galapagos Syndrome,” which refers to technology development in remote and isolated environments, such as the Galapagos Islands. Given that sensitive technologies are optimized in a very specific environment and have no market outside it, they soon become obsolete when highly versatile and innovative technologies emerge. This process known as disruptive innovation can entirely change the technology landscape and kill older and protected technologies. The situation might be different for military-related sensitive technologies given that they usually require large-scale and long-term investment for research and development. However, it is also true that emerging technologies such as cheap drones used in the Nagorno Karabakh conflict in September 2020 could potentially undermine the superiority of U.S. air defense technology in certain areas given that very expensive U.S. missile defense systems might not be cost effective to intercept cheap drones. Therefore, it is important for Japan and the United States to prevent technology leaks in areas where they already have an advantage, and at the same time, develop disruptive technologies ahead of their rivals and deploy them in society. Cooperation between

³² Kazuhito Yamashita, “Agriculture ruined and Agriculture Cooperative survives,” *RONZA*, May 26, 2020, <https://webronza.asahi.com/business/articles/2020052300006.html>.



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Japan and the United States in the social implementation of innovative technologies will be particularly useful in the context of supply chain resilience and infrastructure development.

Japan's infrastructure export policy initially began with the promotion of domestic engineering and heavy industry. But the recently revised strategy titled “Infrastructure System Overseas Promotion Strategy 2025,”³³ unveiled in 2020, expanded its policy objectives and it now includes the FOIP concept introduced by the Abe government in 2016. The new strategy also expanded the range of policy measures by including support for technology development. In this respect, this policy is no longer limited to the conventional meaning of infrastructure.

Japan and the United States can work together to support technology development and its social implementation. The U.S. Indo-Pacific Strategy released in February 2022 proposes a similar action plan as a part of Quad cooperation.³⁴ The problem is that Japan-U.S. cooperation under FOIP is still predominantly conceptual, and there have been limited tangible results. This could be partly due to the leadership change in U.S. government agencies following the 2020 presidential election and limited face-to-face meetings at the working level because of the pandemic. But now, Japan and the United States should focus on the fruits of cooperation. For this purpose, the division of roles between Japan and the United States should carefully be considered. In November 2018, the United States International Development Finance Corporation (USDFC, then the Overseas Private Investment Corporation or OPIC), JBIC and Australia's Export Finance and Insurance Corporation (EFIC) agreed to work together on financing infrastructure, energy, and national resource sectors in third countries including in the Indo-Pacific region. But the only project that has been realized since then is the submarine cable project in Palau in 2021. There are not many opportunities for Japanese, U.S., and Australian companies to work together on the same projects and focusing only on such projects makes it difficult to bring about tangible results. Rather, it is important for Japan, the United States, and Australia to formulate a common strategy to determine how each player performs its role to complement each other's strengths and weaknesses.

However, there are many constraints in each party. For example, USDFC cannot provide finance to government agencies and JBIC's untied finance is designed to support green projects such as renewables. It is not very clear to what extent JBIC is able to use untied programs beyond supporting green projects. To deliver many tangible outcomes, both parties should redouble their efforts to maximize their flexibility.

³³ Prime Minister's Office of Japan, “Outline of 2025 Policy Program for Promotion of Overseas Infrastructure Systems (Infrastructure System Overseas Promotion Strategy 2025),” December 2020, <https://www.kantei.go.jp/jp/singi/keikyou/dai49/siryou1e.pdf>

³⁴ *The Indo-Pacific Strategy of the United States*, The White House, February 2022, <https://www.whitehouse.gov/wp-content/uploads/2022/02/U.S.-Indo-Pacific-Strategy.pdf>



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Conclusion

Japan's economic security policy has evolved in response to changes in potential threats to Japan. However, the rise of China as a global power has opened a new chapter of Japan's economic security policy. In addition, effective policy measures outside of the use force are becoming increasingly important, as in the case of Russia's invasion of Ukraine in February 2022. This also demonstrates the need for broader economic policy options to fill the gap of growing uncertainty in East Asia. The rules of the game have changed, and U.S.-Japan cooperation is more important than ever. But there are many challenges ahead to better coordination. In particular, key issues will be: (i) the information exchange mechanism between the United States and Japan, (ii) new export control framework with a small group of like-minded countries, (iii) human rights issues in economic security policy, (iv) incentives to gain private sector cooperation, (v) a well-considered policy design and transparent implementation to avoid protectionism, and (vi) support for development and social implementation of innovative technologies in areas such as infrastructure development. The United States and Japan should discuss these issues in a comprehensive manner and formulate a common strategy of economic security.