Economic Security: Boon or Bane for the US-Japan Alliance?

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Introduction

Economic security policies driven by the desire to hone technological capabilities and hedge against the risks of overdependence and supply chain disruption are on the rise. Across Asia and Europe, governments are developing novel foreign economic policy toolkits to maximize benefits and minimize drawbacks of economic interdependence amidst geopolitical rivalry. This paper assesses the drivers and implications of the shift toward embracing economic security frameworks in the United States and Japan. It underscores the strong alignment between the two allies in their mutual desire to extract the benefits of technological innovation, codify rules on trade and technology, and meet the China challenge. The paper also highlights areas where there are visible gaps in policy prescription and implementation between the United States and Japan: striking a balance between economic engagement and economic hedging, tensions between onshoring and friend-shoring incentives, and repurposing export controls to slow down Chinese technological
development. The newly established US-Japan ministerial economic 2+2 (known as the Economic Policy Consultative Committee) should make coordination in these areas a key priority.

Economic security as an organizing principle of American statecraft

A major recalibration of US foreign and domestic economic policy is underway. The dictum “economic security is national security” now shapes the strategies of both Republican and Democratic administrations, even if there are differences in the overall approach and tactics of the Trump and Biden administrations. This organizing principle of American statecraft made its debut in the 2017 National Security Strategy (NSS) when the Trump presidency embraced fully the concept of great power competition and pledged peace through strength. It was evoked yet again in the 2021 Interim National Security Strategic Guidance when the Biden administration committed both to compete with China and to expand the American middle class. In the recently released 2022 NSS, the term economic security is not used explicitly, but its influence is pervasive through the identification of challenges posed by competition with autocracies, the call for cooperation with allied technologically developed democracies, and the identification of the key priorities for sustaining an advanced innovation economy and shaping the rules of the road on trade and technology.

A main driver behind the fusion of economics and national security in US foreign policy is the deepening strategic competition with China. Economic bilateral friction is long-standing. The impact on American factory jobs of low-cost Chinese imports and China’s theft of intellectual property to catch up with the West are well-known grievances. However, a more acute sense of apprehension is palpable with the realization that China’s economic reform spirit has waned, Chinese Communist Party (CCP) leadership has advanced civil-military fusion, and the country has greater technological capability and ambition both to modernize its military and augment its economic clout.

The re-emergence of great power competition in the international system is profoundly different from the Cold War era that pitted the United States against the Soviet Union and divided the world into two opposing camps. Two main differences stand out. One is the sharp and fast deterioration of US-China relations that took place after a decades-long process of their economic integration, and China’s emergence as a central hub in global supply chains. Managing rivalry in the midst of deep economic interdependence is essential to understand contemporary US-China relations. Relatedly, US allies, partners, and most regional actors also intensified their economic exchange with China while continuing to rely on the US for its security role (either through a direct defense commitment or through America’s contributions to regional stability and freedom of navigation). This more benign external environment—reliance on the United States for regional security and on China for regional growth—is under growing strain.4

The second difference is that while US-China competition is multidimensional, a key defining trait is the centrality of economic objectives and economic tools to this great power contest. The race is on to see which country can emerge as the most sophisticated technological powerhouse and in doing so achieve strategic indispensability in advanced manufacturing and shape trade and technology rules. Economic instruments are essential to this endeavor and can be placed in two broad categories. On the promotion side, industrial policy measures, investments in innovation and research, and coordination efforts to disseminate technology standards figure prominently. On the protection side, a defensive toolkit to secure critical technology and infrastructure and increase the resilience of supply chains is under development. In other words, the era of US-China strategic competition has brought about a renaissance of economic statecraft (i.e., the use of economic means to achieve foreign policy objectives) and this iteration is keenly attuned to the opportunities and challenges presented by extant patterns of globalization and the on-going technological revolution.

As a result, we are witnessing today the “securitization of international economic relations” with a growing emphasis on the national security implications of trade, investment and technology flows, and the weaponization of economic interdependence through the control of chokepoints in

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4 Multiple factors are at work here including polarized American politics that produce sharp fluctuations in US foreign policy, and the marked slowdown of the Chinese economy and growing uncertainty for foreign investors due to Zero-COVID and Common Prosperity policies.
the supply chain or the use of import sanctions to punish targeted nations, to name some examples.5 The United States and China embarked on a trade war in 2018 with a rapid tit-for-tat escalation in tariffs and counter-tariffs that remain today and cover a substantial share of bilateral trade. Nevertheless, the key battleground is technology. Referred to as platform technologies or force multipliers, the fast clip of development in artificial intelligence (AI), supercomputing, biotechnology, and microelectronics (particularly integrated circuits) creates a strong impetus to outcompete rivals and correct against vulnerabilities utilizing the new tools of economic security.

Through executive regulation, legislative action, and diplomatic endeavor, the United States has begun to articulate and implement new initiatives on export controls, screening of foreign direct investment (FDI), supply chain resilience, and industrial policy; all undergirded by the twin logics of economic security (promotion and protection). While not an exhaustive list, some of the most important developments include the following measures.

1. Tightening FDI screening

With the 2018 Foreign Investment Risk Review Modernization Act (FIRRMA), the United States expanded the national security review of inward direct investments. The Committee on Foreign Investment in the United States (CFIUS) is now tasked with reviewing non-controlling investments in sectors involving critical technologies, critical infrastructure, and personal data. In a first, the Biden White House provided specific guidance to CFIUS in fall 2022 on national security risk assessments. The administration urged consideration of the impact of inward FDI projects on the US technological lead, cybersecurity, and the resilience of critical supply chains. Another novelty was the instruction for CFIUS to consider not just the impact of individual transactions, but industry investment trends that can result in a national security risk.6

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5 A fuller discussion of the drivers and implications of economic security policies in Asia can be found in my forthcoming book “Japan’s Quiet Leadership: Reshaping the Indo-Pacific,” Brookings Institution Press.
2. Revolutionizing export controls

The 2018 Export Control Reform Act marked an important shift in US export control policy to include emerging and foundational technologies in the licensing requirements for dual-use products.\(^7\) Further changes were afoot in the use of the Entity List to address the national security risks posed by Chinese technology firms subject to the CCP’s political control. Such concerns led the Trump administration to place Huawei corporation on the Entity List in May 2019. With that regulatory action, American companies were required to obtain a license to sell microchips and equipment to Huawei. In May 2020, the US Department of Commerce made a novel application of the Foreign Product Direct Rule (FPDR) to mandate that foreign firms utilizing American software or equipment were subject to the US export controls.\(^8\) The objective was both to close loopholes in cutting off Huawei’s access to chips and to ensure American firms were not uniquely disadvantaged from the imposition of the tech restrictions.

In the wake of Russia’s invasion of Ukraine in February 2022, the United States has worked in earnest with European and Asian allies to put together an unprecedented package of economic sanctions that, among other measures, cut the supply of technology products to Russia. The effort was notable not only because of the unity of purpose and the broadness and impact of the sanctions package, but also because these plurilateral export controls have proven highly effective and have come to enjoy greater legitimacy due in part to participating governments sharing in the burden of ensuring compliance.\(^9\)

On October 7, 2022, the Bureau of Industry and Security (BIS) at the Department of Commerce issued a complex set of export control rules that will curtail the supply to China of high-capacity chips for AI and supercomputing (while granting a one-year reprieve to manufacturers SK and TSMC for their operations in China). This set of controls will also restrict sales of software and equipment for the production of logic chips at or below fourteen nanometers, and will apply


restrictions to US persons who assist Chinese manufacturing activities in the controlled sectors.\textsuperscript{10} Once more, the US Government invoked the FPDR mandating extraterritorial compliance for any company, regardless of its country of origin, that uses US software and equipment in transactions involving advanced computing activities in China or firms placed on the Entity List.\textsuperscript{11} While the rules are targeted to a specific class of semiconductors, they will have far and wide implications. For one, they imply that the United States takes China’s civil-military fusion at heart and will restrict access to critical emerging technologies.\textsuperscript{12} This development also raises the question of whether the US will unilaterally define the frontier of tech competition with China or if it will succeed in garnering agreement from its allies to set a common export control approach.

3. Supply chain resilience and industrial policy

The Biden administration conducted a review of supply chains for semiconductors, large-capacity batteries, pharmaceuticals, and critical minerals and released a report in mid-2021. The purpose of this exercise was to identify potential vulnerabilities and offer corrective measures. For instance, regarding semiconductors the report warned about the lack of cutting-edge chip production based in the US and the excessive concentration of advanced chip manufacture in Northeast Asia. To remedy this situation, the report touted the benefits of friend-shoring to boost supply chain resilience and called for boosting major domestic investment in R&D, investment incentives, and human capital development.\textsuperscript{13}

After a protracted legislative battle, the US Congress finally passed the CHIPS\textsuperscript{14} and Science Act in summer 2022. The $280 billion funding bill is geared to promote US technology competitiveness and measures to help meet the China challenge. Key highlights include the establishment of a Technology Directorate at the National Science Foundation to nurture

\textsuperscript{14} Creating Helpful Incentives to Produce Semiconductors
commercial technologies and the allocation of $52 billion to promote chip manufacturing in the United States. The carrots come with strings attached, however, in that recipients cannot significantly expand their operations in countries of concern like China.

4. Allied coordination on economic security measures

Coordination with allies on economic security measures has been an important priority for the Biden administration. Some of the most significant coordination efforts include the launch of the Trade and Technology Council with the EU and the emerging technologies working group in the Quad (US, Japan, India, and Australia), the implementation of the Competitiveness and Resilience (CoRe) Partnership and an Economic 2+2 with Japan, and the establishment of joint initiatives on supply chain resilience and dual-use export controls with South Korea. On the sidelines of the 2022 East Asia Summit, the United States, Japan, and South Korea inaugurated an economic security dialogue as part of a broader Indo-Pacific trilateral partnership. Given the complexity of global supply chains and the need to pool resources in advanced manufacturing and international standards-setting, minilateral coordination is essential. At the same time, given that economic security diplomacy has been pursued in separate tracks involving different partners, there is the potential of creating stovepipes, duplicating efforts, and ultimately developing disparate rules.

From comprehensive security to economic security in Japanese economic statecraft

Japan is no stranger to the perils of economic dependence especially during times of geopolitical transition. For a resource poor country, securing a stable supply of food, energy, and minerals to satisfy the consumption needs of its population and the industrialization drive of its economy has long been a primary concern. Addressing economic vulnerabilities, therefore, figured prominently in the Masayoshi Ohira administration’s Comprehensive Security Strategy released just as the tumultuous 1970s—which had delivered oil price hikes and Nixon shocks—drew to a close. The following decade would be an eventful one. As Deng Xiaoping’s opening and reform policies in China continued to make headway, the internationalization of Japanese manufacturing proceeded.

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15 “U.S.-Korea launch dual-use export controls working group,” Inside U.S. Trade, November 9, 2022.
at a vertiginous pace in the mid-1980s. Japanese firms responded to the sharp yen appreciation with a wave of overseas investments that led to the creation of regional production networks. China, with its plentiful supply of low-cost labor, emerged as a central hub in ever more sophisticated supply chains.

Supply chain trade integration with flows of goods and components moving in both directions created mutually beneficial economic opportunities—there was no debate in Japan on the decimation of factory jobs to Chinese competition (unlike in the US) which helped spare the country a globalization backlash. But trade and investment integration did create new forms of dependency and levers for the Chinese government to deploy as it began to push its expansive territorial claims. In 2010, the Japanese government arrested the captain of a Chinese trawler which had rammed a Japanese Coast Guard vessel in the waters surrounding the Senkaku islands. China’s pressure campaign included an informal export embargo of rare earth metals critical to Japan’s manufacturing industry. This episode encapsulated the onset of Japan’s new China challenge: How to handle a more capable military power willing to use gray zone tactics and push the levers of economic exchange for political advantage.

Japan’s response to this early instance of Chinese economic coercion focused on three fronts: rationalization and recycling efforts by the private sector to reduce demand, diversification by exploring alternative sources of rare earth metals, and a legal challenge through the World Trade Organization (WTO) which yielded a positive outcome for Japan.17 It was a response centered on dealing with the export embargo, but not yet a full-blown articulation of an economic security strategy weaving together diverse policy domains. That would come later. Japanese economic statecraft kicked into high gear in the 2010s, but it was the connectivity track that moved full steam ahead as Japan emerged as a champion of trade agreements and a supplier of sustainable infrastructure finance. There was indeed an element of competition with China, but it was a contest over which Asian power could stitch the region closer together.

The intensification of great power competition with the arrival of Donald Trump to the White House and the consolidation of Xi Jinping’s power in China provided impetus for Tokyo’s economic security turn. Concerns with China’s direction under Xi had only intensified over the course of the decade. Beijing had used the occasion of the Government of Japan’s purchase of the Senkaku Islands from its private owner in late 2012 to alter the status quo with frequent intrusions in the proximate waters to challenge Japan’s administrative control. China’s penchant for self-sufficiency in the most advanced technological sectors and its doubling down on state capitalism practices threatened to erode economic complementarity and fairness. Beijing’s more frequent recourse to economic coercion to punish regional actors for foreign policy disagreements illustrated all too well the risks of economic reliance on China. How to hedge against the security and economic risks of a more assertive China without undermining a vast trading relationship that is key to Japan’s prosperity is a paramount question for Japanese strategic planners.

The American rethink on trade policy and engagement with China under President Trump prompted a major recalibration in Japan’s foreign economic policy. On the one hand, the US withdrawal from Trans-Pacific Partnership (TPP), the abuse of “national security” tariffs against allies, and the US-China trade war aggravated concerns over the rise of protectionism and US unilateralism. On the other hand, Tokyo welcomed the more skeptical US view of China (if not its methods) and shared in the concerns over China’s theft of intellectual property, leaks of critical technologies, and cyber and information security risks posed by Chinese telecommunications giants. In late 2018, Tokyo banned the use of telecommunications equipment in government agencies deemed to pose a national security risk. In 2019, Japan introduced reforms to tighten the screening of FDI for national security purposes. A year later, economic security divisions were added to Japan’s NSS and the Ministries of Foreign Affairs and Economy, Trade and Industry. In 2020, government and Liberal Democratic Party (LDP) documents seized on two critical concepts to guide Japan’s economic security policies: strategic autonomy (correcting for overdependencies) and strategic indispensability (increasing the reliance of others on Japan in cutting-edge industries). In spring 2022, the Japanese Diet passed the Economic Security Promotion Law covering four main areas: supply chain resilience, protection of critical infrastructure, promotion

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of research and innovation, and concealed patents. The speed of policy change over the past five years as Japan began to systematically develop its economic security toolkit has been notable.

**Allied cooperation on economic security: Opportunities and challenges ahead**

In maintaining an open, resilient, and prosperous Indo-Pacific, the Biden administration has attached a premium on collaboration with allies and like-minded countries. Japan is an important partner in this endeavor as a close ally, fellow democracy, and technologically advanced economy. Individually and in collaboration, the United States and Japan have pursued new policies on cybersecurity, investment screening, supply chain resiliency, export controls, and the promotion of semiconductor manufacturing, to name a few. There are, however, some important gaps between the allies on priorities, capabilities, and preferred policy tools. Addressing these areas will have important implications for the role of economic security in bilateral ties and will reshape relations with China and the future economic order. The following three areas in particular merit further discussion.

1. **Economic statecraft and the China challenge**

There is a sharp difference between the United States and Japan on the overall balance achieved in their foreign economic policies between the pursuit of economic connectivity and economic security. While the United States has moved swiftly to boost its economic security toolkit, its economic engagement policies in Asia continue to underwhelm. American unilateral actions regarding tariffs and tech restrictions have been a source of worry for Japan and other allies. There is also concern about the lack of US interest in pursuing ambitious trade liberalization and an unmet expectation for an American return to the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). The US Indo-Pacific Economic Framework (IPEF) is just in its early days of negotiation, but lingering doubts remain about the ability of President Biden’s initiative to generate substantial benefits for participants in the absence of market access preferences and of disseminating cutting-edge rules without an effective enforcement mechanism. The longevity of a framework that will not be subject to congressional ratification is also in question. For the reasons above, IPEF may not provide the robust and long-term economic engagement with regional partners, nor will it become an effective enterprise to compete with China’s trade diplomacy.
In contrast, Japan’s economic security policies have come into place after a substantial push for economic engagement (trade negotiations, digital economic standards, infrastructure finance). This has included the rescue of the TPP a few years back, and today the enlargement of the CPTPP as the list of accession applicants grows. Because the United States walked away from the TPP, it will not have a vote in China’s accession bid. It is up to Japan and the other members to chart a path regarding the delicate handling of China’s CPTPP entry request.

Regarding overall China policy, the United States seems poised for comprehensive competition framed by the Biden administration as a performance contest between democracies and autocracies. Japan’s China policy remains geared toward selective competition and selective collaboration. Regional trade diplomacy is an arena in which these differences will play out. IPEF does not contemplate the inclusion of China, whereas Japan is part of Regional Comprehensive Economic Partnership (RCEP), the largest trade agreement in the world with China as a member.

Finally, there are differences in the nature of the trading relation with China. Japan is more dependent on China (relative import and export shares) and supply chain trade plays a larger role. Any partial or far-reaching decoupling from China is likely to have asymmetrical impacts. For example, a recent simulation by Góes and Bekkes estimates that the welfare losses (decreases in real GDP by 2040) from the emergence of two global blocs are steeper for Japan than for the United States.

2. Supply chain resilience and competition for advanced manufacturing

The United States and Japan are concerned with overdependence on China for critical products and are interested in early detection systems to increase the resilience of supply chains. Both the United States and Japan are gearing up to provide industrial subsidies to attract foreign foundries


(TSMC in Japan and TSMC and Samsung in the United States) in order to increase domestic semiconductor manufacturing. Friend-shoring, therefore, has appeal in both countries.

Nevertheless, the United States’ supply chain policies carry a hefty dose of onshoring which creates friction with its partners. For instance, after completing its supply chain review, the Biden administration has strengthened “Buy America” provisions. The tax credits for electric vehicles (EVs) awarded in the Inflation Reduction Act (IRA) are a major bone of contention between the United States and allies in Europe and Asia.21 The bill mandates that in order to receive up to $7,500 in tax credits, the vehicles must be assembled in North America, and it will require that 40% of critical minerals used in EV batteries be procured in the US or an FTA partner by 2024. There is also the very real risk that the revival of industrial policy in market economies may create tensions amongst them. The race to provide investment incentives to firms along the semiconductor supply chain is not only between China and the West, but also ongoing among friends. Avoiding a subsidy war is therefore a major concern.22

3. Technology competition with China and the future of export controls

Recent statements by National Security Advisor Jake Sullivan and the October 7 adoption of long-arm export controls on high-capacity chips for AI and supercomputing mark a new era for US-China technology competition. For the United States, it no longer seems sufficient to keep relative superiority vis-a-vis China, but absolute advantage is the new goal.23 Behind this important shift is the US conclusion that China’s civil-military fusion renders control over critical technologies a national security priority. The transformation in US export controls raises the question of whether US allies and partners are on board with defining the competition with Beijing in terms of stalling China’s technological development in critical areas. Despite months of consultations with allies, the October 7 export controls are unilateral with extraterritorial provisions. Hence, a major effort is underway to secure ally buy-in, especially from the Netherlands and Japan given the lead of

Dutch and Japanese companies in chip toolmaking.24 The outcome of the US diplomatic campaign is still unknown at the time of this writing. Understanding how Japan and the US conceptualize and reform their export control policies, therefore, is of critical importance to discussions about a future plurilateral export control regime in light of the limitations of the multilateral agreements such as Wassenaar Arrangement.