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DGAP POLICY BRIEF

Japan's "Economic Security" Measures

A Model for Managing China's Rise



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Japan and Germany face an acute dilemma. China, a key trading partner for both nations, uses political warfare and economic statecraft to advance its interests. Like Germany, Japan has a strong SME economy and auto industry, and has dependencies on China. Yet Japan faces more risk due to its geographical proximity to China and territorial disputes. As global tensions grow, Japan is responding robustly by building economic security. Germany, together with the EU and other like-minded partners, should do the same.

- Germany must diversify its trade and economy to build resilience and lessen existing risky dependencies on China.
- The German government should support businesses, especially future industries in the AI, quantum, biotech, and health sectors via state funds and public-private partnerships, and ensure they are not forced to seek funding from unsafe partners. It should also look much more closely at research cooperation with risky partners and halt ongoing outflows of intellectual property.
- Germany should create a framework for overarching, all-of-government thinking, sidestepping bureaucratic silos to enable long-term and flexible, strategic decision-making. At the same time, strategic communication with the public is essential.

JAPAN'S SECURITY ARCHITECTURE

As perpetual tensions between Japan and China over ownership of the Senkaku or Diaoyu islands in the East China Sea¹ flared anew approximately ten years ago, China imposed an unofficial trade embargo on rare earth exports to Japan, as punishment. Spooked by this measure that threatened its supply chains and thus economy and industry, Japan began to build a stronger national security structure to identify and protect its interests. The first step was establishing a National Security Council in 2013, followed by a National Security Secretariat the next year. Today, Japan is in an intensive policy-making and legislative phase that deepened in reaction to the challenges of the COVID-19 pandemic and is expected to last until at least the end of 2023.

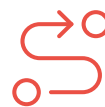
Relations between Japan and China have long been sensitive due to Japan's invasion of China in the Second World War. Still, diplomatic relations with the People's Republic of China (PRC) are longstanding. Japan and China established diplomatic relations in 1972, the same year as Germany. Both countries mark the 50th anniversary of ties this year.

The basic national security architecture Japan set up nearly a decade ago was fleshed out in 2020 with the addition of a crucial economic security division within the National Security Secretariat (NSS), headed by Shigeru Kitamura, who was director of the NSS at the time. It includes officials from the ministries of finance, foreign affairs, internal affairs and communication, and the National Police Agency. This broad range of staff reflects Japan's understanding that the China challenge is cross-cutting, and an internal awareness that ministerial silos weaken responses.

In line with this "all-of-government" approach there is no lead ministry in the economic security project, but there is an economic security minister: Takayuki Kobayashi, a former finance ministry official, appointed by Japanese Prime Minister Fumio Kishida in 2021. An Economic Security Committee took up work later that year, an offshoot of a "new international order" working group of the ruling Liberal Democratic Party. That group was headed by Kishida, who

became prime minister in late 2021. As a result of all these efforts,² an "Economic Security Protection Law," focusing on supply chain security and other issues, is due to be submitted to the Japanese parliament (the Diet) in late February 2022. While the definition of "economic security" remains vague, it includes the following:

THE FOUR PILLARS OF A PLANNED "ECONOMIC SECURITY PROTECTION LAW"



STRENGTHEN
SUPPLY NETWORKS



ENSURE THE SECURITY
OF KEY BASIC
INFRASTRUCTURE



EXPAND PUBLIC-PRIVATE
TECHNOLOGICAL
COOPERATION



SHIELD FROM PUBLIC VIEW
PATENTS ON TECHNOLOGIES
THAT CAN BE USED FOR
MILITARY PURPOSES

Japan's economic security efforts look to apply traditional security or military thinking to economic affairs, in order to create greater resilience in an increasingly tense international situation.³

SUPPORT FOR JAPANESE BUSINESS

Like Germany, Japan has a flourishing small- and medium-business sector. For some years Tokyo has been quietly encouraging these firms, as well as bigger industries, toward a "China plus one" strategy,

1. Gisela Grieger, "Sino-Japanese controversy over the Senkaku/Diaoyu/Diaoyutai Islands: An imminent flashpoint in the Indo-Pacific?", Briefing, European Parliament Think Tank (July 7, 2021): <[https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI\(2021\)696183](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2021)696183)> (accessed February 4, 2022).

2. Keizai anzen hoshō hōsei ni kan suru yūshikisha kaigi [Expert council concerning the legislation on economic security guarantees], "Keizai anzen hoshō hōsei ni kan suru teigen [Recommendations concerning the legislation on economic security guarantees]", Cabinet Secretariat (February 1, 2022): <https://www.cas.go.jp/jp/seisaku/keizai_anzen_hosyohousei/dai4/teigen.pdf> (accessed February 4, 2022).

3. Goto Tadashi, "Arata na 'bōeiryoku' – Keizai anzen hoshō to ha nani ka? [A new 'defense capability' – what are economic security guarantees?]", Nippon Hōsō kyōkai (NHK) [Japan Broadcasting Company] (October 10, 2020): <<https://www.nhk.or.jp/politics/articles/feature/46667.html>> (accessed February 4, 2022).

to diversify away from China, and towards ASEAN countries, in particular. The government gave overt support to this effort in 2020 with a series of subsidies for a "Domestic Investment Protection Project". A first tranche of 2 billion euros that year aimed to redirect investments and help re-shore businesses to Japan. More money followed in two further budgets, giving a total of 4 billion euros. In addition, the government has announced a 4 billion euro R&D fund to create economic security in key technologies domestically.

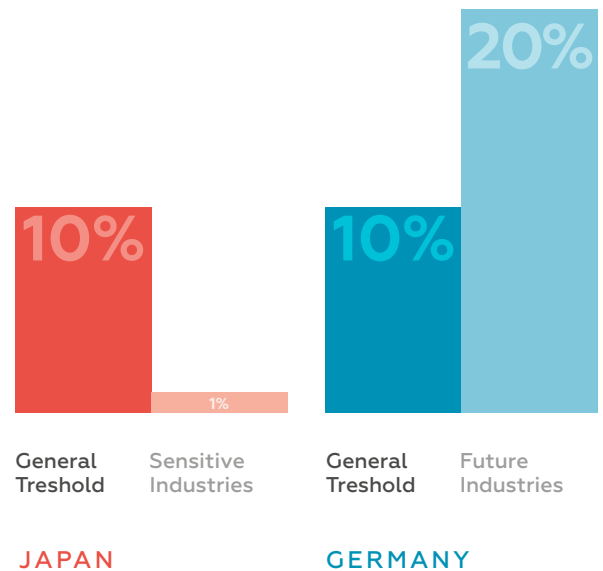
INWARD INVESTMENT SCRUTINY

In 2021, Tokyo lowered the threshold for which approval must be sought for foreign direct investment (FDI) into designated industries, from 10 percent to 1 percent. Under Japanese law, an investor can make formal proposals at a shareholder meeting if they hold just a 1 percent stake. This means any future shareholder with the ability to steer or influence company internal decision-making needs pre-approval. Investment into Japan is already comparatively low, but the new threshold includes exceptions, such as for sovereign wealth funds or banks from specified countries, to prevent these new rules triggering a further drop-off.

The government has barred foreign investment from 15 "core" sectors, including nuclear power, railways, critical minerals, and, in the wake of the Covid-19 pandemic, parts of the pharmaceutical and medical device industries. The finance ministry publishes a list of companies in these restricted categories. Companies are only added to the list if they self-identify as being in a restricted industry. For foreign direct investment, the onus is on the investor to determine whether they need to notify the finance ministry of their investment in advance (so-called "prior-notification").⁴

Japan's low threshold for FDI contrasts to Germany, where a 10 percent level still applies across the board. In 2021, Germany actually raised the FDI threshold to 20 percent for Emerging Disruptive Technologies (EDT) including quantum, AI and semi-conductors, due to pressure from businesses. Essentially this was a political decision, reflecting the country's desire to attract foreign capital for its start-up sector. Balancing the needs of business

FOREIGN DIRECT INVESTMENT SCREENING THRESHOLDS IN JAPAN AND GERMANY



Quellen: Bundesministerium für Wirtschaft und Klimaschutz, "BMWi bringt Zukunftsthemen auf den Weg", Press release (April 27, 2021), <<https://www.bmwi.de/Redaktion/DE/Pressemitteilungen/2021/04/20210427-bmwi-bringt-zukunftsthemen-auf-den-weg.html>> (last accessed February 4, 2022). | Ministry of Finance Japan, The Objective of the Amendment to the Foreign Exchange and Foreign Trade Act, (March 24, 2020) <https://www.mof.go.jp/english/policy/international_policy/fdi/kanrenshiry-ou_20200314.pdf> (last accessed February 4, 2022).

and of security is extremely difficult, but one can legitimately ask whether this exposes crucial future industries to the risk of unwanted technology outflow, and whether other forms of support for startups would be safer, such as domestic or EU funds, or like-minded country funding.

CRITICAL TECHNOLOGY INDUSTRIES

Japan has proved willing to make exceptions to its FDI rules and accept high levels of foreign investment for specific sectors and specific allies. This contrasts to Germany, where such inward investment may be curtailed regardless of the partner, including from its treaty ally the United States, or

4 Ministry of Finance, Japan, "Update of the List of Classifications of Listed Companies regarding the Prior-notification Requirements on Inward Direct Investment", (November 2, 2021); <https://www.mof.go.jp/english/policy/international_policy/fdi/20211102.html> (accessed February 4, 2022).

Taiwan. Germany's approach is motivated by its apparent pursuit of "European strategic autonomy" in key sectors. A case in point was the German economics ministry's recent failure to approve a bid by Taiwan's GlobalWafers to purchase Siltronic – a German manufacturer of silicon wafers, which forms part of the semiconductor industry.

The government in Tokyo is investing 600 billion yen⁵ (nearly 5 billion euros) in the semi-conductor manufacturing sector to reverse its decline. This figure includes an investment of 300 billion yen (approximately 2.5 billion euros) in a chip plant in Kumamoto,⁶ known as "Silicon Island", in southwest Japan. This project is a joint venture between Sony and Taiwan's TSMC (Taiwan Semiconductor Manufacturing Corporation).

In its 2021 defense white paper,⁷ for the first time, Japan said it regards stability for Taiwan as "important for Japan's security", given the proximity of Japanese islands to Taiwan and Japanese reliance on the Taiwan straits and other related sea lanes. It noted "a sense of crisis"⁸ over China's repeated military threats to Taiwan. Additionally, the Liberal Democratic Party, the majority power holder in the Japanese government, has established a Taiwan project team,⁹ to begin cooperation under the policy of strategic ambiguity.

RESEARCH SECURITY AND TECHNOLOGY TRANSFER

Spooked by evidence of persistent technology outflow¹⁰ to China, Japan restricts access to sensitive

technologies for visiting scholars who are resident for less than six months. In future, it is likely that scholars resident for longer than six months who are involved in "critical research areas" will require approval¹¹ from the Ministry of Economics, Trade and Industry. Sensitive research positions will increasingly be withheld from PRC researchers and persons deemed to be "strongly influenced" by another state. This reflects concerns over political pressure and technology transfer.

Chinese students may also be barred entirely from certain high-tech areas. Japan's end-user export control list¹² includes 86 Chinese entities deemed to pose security risks. Of those, roughly one-quarter are higher education or research institutes, including Harbin Institute of Technology, Beihang University, Northwestern Polytechnic University, and others belonging to a group known as the "Seven Sons of National Defense".¹³ Despite this, there are currently extensive joint research and visiting scholar programs between Japan and China.

In a further step to protect innovation, Japanese authorities plan to curtail the publication of high-technology patents that have military applications. This is a wide-ranging problem faced by Japan due to China's state policy of "military-civil fusion", which explicitly merges non-military and military use of technologies. International patent scrutiny is one of 32 known methods of Chinese technology transfer. Like all developed industrialized nations, Japan is a target of China's vast technology transfer system. Japan has been a target of technology transfer since 1978 of the China-Japan Treaty of Peace and Cooperation was signed. This treaty ushered in an era

5 Nikkei staff writers, "Japan allocates \$5.2bn to fund chip plants by TSMC and others: Micron and Kioxia set to get subsidies for domestic memory chip factories", *Nihon Keizai Shinbun Asia* (Nikkei Asia) [Japanese economic newspaper Asia] (November 23, 2021): <<https://asia.nikkei.com/Business/Tech/Semiconductors/Japan-allocates-5.2bn-to-fund-chip-plants-by-TSMC-and-others>> (accessed February 4, 2022).

6 Kumamoto is both the name of a prefecture and its capital on the westernmost of the main islands of the Japanese island chain (excluding Okinawa), Kyūshū. Today, it is among the most relevant hubs for semiconductor, electronics, and automobile production in Japan.

7 Ministry of Defense, Japan, *Defense of Japan 2021*, Defense White Paper (2021), p. 19: <https://www.mod.go.jp/en/publ/w_paper/wp2021/DOJ2021_EN_Full.pdf> (accessed February 4, 2022).

8 Ibid.

9 Jiji, "Japan's LDP plans security talks with Taiwan's ruling party", *Japan Times* (August 18, 2021): <<https://www.japantimes.co.jp/news/2021/08/18/national/ldp-taiwan-party-talks/>> (accessed February 4, 2022).

10 Nikkei staff writers, "Japan allocates \$5.2bn to fund chip plants by TSMC and others: Micron and Kioxia set to get subsidies for domestic memory chip factories", *Nikkei Asia* (November 23, 2021): <<https://asia.nikkei.com/Business/Tech/Semiconductors/Japan-allocates-5.2bn-to-fund-chip-plants-by-TSMC-and-others>> (accessed February 4, 2022).

11 Nikkei staff writers, "Japan to limit foreign students' access to security-linked tech: Universities will need Tokyo's approval to teach foreign government-sponsored students", *Nikkei Asia* (October 26, 2021): <<https://asia.nikkei.com/Politics/Japan-to-limit-foreign-students-access-to-security-linked-tech>> (accessed February 4, 2022).

12 This list was last revised and republished on September 17, 2021. Ministry of Economy, Trade and Industry, *End User List*, (September 17, 2021): <https://www.meti.go.jp/policy/anpo/2_0917.pdf> (accessed February 4, 2022).

13 Australian Strategic Policy Institute International Cyber Policy Centre, "Terminology", *China Defense Universities Tracker* (last updated May 2021): <<https://unitracker.aspi.org.au/glossary/#:-:text=The%20Seven%20Sons%20of%20National%20Defence%20%28%E5%9B%BD%E9%98%B2%E4%B8%83%E5%AD%90%29%20is,halfof%20their%20research%20budgets%20on%20defence%20research>> (accessed February 4, 2020).

of "learning from Japan", as Chinese state media describe it.¹⁴

LAND SALES

A decade ago, Japan's prefectures noticed an increase in Chinese and North Korean property acquisition near Japanese and American military bases in Japan, near nuclear plants, and on sensitively situated islands. To prevent surveillance of personnel, equipment, materials, and technologies, the Ministry of Defense has conducted initial reviews of land ownership in the vicinity of 650 military installations since 2013.¹⁵

An "Important Land Survey Bill"¹⁶ was also passed in March 2021 that requires prior notification for land purchases within one kilometer of installations of critical infrastructure belonging to the US and Japanese militaries, the coast guard, areas bordering or facing international waters, and uninhabited or remote islands. Prior notification documentation must include the nationality of the buyer and their intended purpose for the land.

This bill will go into effect in April 2022 and a new land utilization council is set to oversee its implementation.¹⁷ There are penalties for non-compliance, including fines, prison time, and potentially forced land sales. Germany currently has no restrictions on land or property purchase on its territory by non-Germans or non-EU nationals.

INTERNATIONAL TRADING AND SECURITY ORDER

Japan, like Germany, is concerned about the erosion of the global rules-based, free, and democratic order. Investing in regional engagement, Japan has taken a lead in building out a new global network of economic partnership agreements (EPAs) and free trade

agreements (FTAs). It is using trade agreements to strengthen rules, for example via the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Taken together, Japan's different trade agreements now cover regions that account for up to 80 percent of global GDP.

China's active diplomacy has led to four of the UN's 15 agencies being run by Chinese nationals. China's clear pursuit of national interests in nominally neutral international organizations is a concern for democracies around the world. Japan is stepping up diplomacy and lobbying to place more Japanese officials into top positions in the international system.

As for hard security, Japan has not yet reformed its constitution to allow for the "normalization" of its military and still has a very restricted capacity to act. This capacity to act was last widened in 2015, with much difficulty. Establishing a pronounced military posture is difficult for Japan's armed forces, which are called the Self-Defense Forces. However, Japan is significantly deepening cooperation with the US and has added Australia and India to its roster of allies to form the Quadrilateral Security Dialogue ("Quad").

CONCLUSION

This report outlines the main moves Japan is making to secure its long-term well-being in the face of a rising China. Importantly, they are embedded in active investment funds and a long-term vision. They walk a tightrope between maintaining the vitality of research and business while protecting national interests. In his New Year's Reflection on January 1, 2022,¹⁸ Prime Minister Kishida noted there were "powerful challenges emerging from the economic system that can also be called state capitalism" – a thinly-veiled reference to China's massive state-owned economy, which follows the Communist Party, as does its nominally private economy. He also emphasized what he called "a new form of capitalism".

14 Li Qing, "The Tour That Helped Change A Nation: The story of how Deng Xiaoping's 1978 trip to Japan helped pave the way for the modernisation of China", *Beijing Review* (first published in China Daily, August 9, 2018): <http://www.bjreview.com/Nation/201808/t20180809_800137860.html> (accessed February 4, 2022).

15 Advisory Panel on assessment of the actual state of land use, "Recommendation for new legislation on assessment of the actual state of land use", *Cabinet Office* (December 24, 2020), p. 4: <https://www.cas.go.jp/jp/seisaku/kokudoriyou_jittai/pdf/021224teigen_en.pdf> (accessed February 4, 2022).

16 Nikkei staff writer, "Anpo kanren no tochi torihiki, jizen todokede wo gimuka hōan kakugi kettei [Land transactions with relation to security, prior notification is made obligatory by law on cabinet decision]", *Nihon Keizai Shinbun* (Nikkei) (March 26, 2021): <<https://www.nikkei.com/article/DGXZQODE252I80V20C21A3000000/>> (accessed February 4, 2022).

17 House of Representatives, Japan, "Jūyō shisetsu shūhen oyobi kokkyō ritō nado ni okeru tochi nado no riyō jōkyō no chōsa oyobi riyō no kisei nado n ikan suru hōritsu [Law on the regulation of use and survey of the current state of use of land in the surroundings of important facilities as well as on border islands etc]", *Law 84* (June 23, 2021): <https://www.shugiin.go.jp/internet/itdb_housei.nsf/html/housei/20420210623084.htm> (accessed February 4, 2022).

18 Prime Minister of Japan and His Cabinet, "New Year's Reflection by Prime Minister KISHIDA Fumio", *Speeches and Statements by the Prime Minister* (January 1, 2022): <https://japan.kantei.go.jp/101_kishida/statement/202201/_00001.html> (accessed February 4, 2022).

Under this vision, “rather than leaving everything to the markets and competition, the important thing is for public and private sector entities to together play their roles, while sharing a common overarching vision for future economic and social reforms”, Kishida said.

Japan and China certainly have a different relationship to that of Germany and China, not to mention other European nations. Yet the core questions and challenges are similar: How to diversify from over-reliance on a massive, non-free trade partner that weaponizes trade?

China's behavior has revealed itself clearly in the unofficial trade embargo it recently imposed on EU member Lithuania, and on companies of other EU countries that are part of the supply chain. Germany is focused on climate protection and is reconfiguring its economics ministry to meet that need, yet it also needs to figure out how to protect crucial technology and support domestic business in order to create more dynamic and future-oriented industries. And it needs to do so while co-ordinating between powerful ministerial silos to achieve it. More intensive exchange with Japan on its own experiences and solutions may help.





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