

# **JAPAN CAUGHT IN THE ECONOMIC-SECURITY DILEMMA**

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## **Introduction**

Japanese policy-makers face a dilemma. The country's national security interests propel it to retain close ties with its long-standing ally and foremost security guarantor, the United States. That impulse becomes even greater given the looming security challenges from an increasingly nationalistic and militarily assertive China and a nuclear-armed DPRK. At the same time, Japan's continued prosperity relies heavily on its economic interdependence with China and East Asia and on retention of the global liberal trading order, all integral to Japanese economic success since the end of World War II.

Yet, a xenophobic U.S. administration now distances itself from Japan and threatens to upend the global liberal order through sustained antagonism against long-standing alliance partners, multilateral institutions, and unilateral trade protectionism. This toxic mix risks bifurcating Japan's security and economic interests. Japan needs a close relationship with the United States; however, U.S. reciprocity is absent. Japan's economic relations pull it closer to China, but security tensions wedge them apart.

This policy brief explores Japan's changing relationships, emphasizing how Japanese policies have been evolving in different directions in security versus economics. It then explores the countermeasures that Japan is taking to reconcile those competing needs. It finishes with several policy recommendations for Japan that might further reduce the strains in the economic-security nexus.

## **Japan's Changing Relationships**

For at least the first 30 years following World War II, Japan's security and economic orientations reinforced one another, creating a virtuous cycle of domestic stability, prosperity, and peace. On security, Japan joined with the United States in its anti-communist policies; meanwhile, its economy flourished under financial and trade mechanisms created by the U.S.-driven global liberal order. U.S. troops and extended deterrence enveloped Japan in a system that offered low-cost external security. Japan's trade and investment partners, in turn, were disproportionately non-communist countries, with the U.S. market taking one-third or more of Japan's surging exports, roughly five times what Japan's second-largest market received.

Japanese economics and security interests began to diverge as the Cold War warmed in East Asia. China and Japan normalized their diplomatic relations in 1972 and signed a Treaty of Peace and Friendship in 1978 that unleashed a torrent of Japanese aid, investment, and technical assistance flowing into China. Further de-icing the Cold War, Chinese leaders undertook economic reforms that jettisoned Maoist state planning and large-scale collectivism in favour of a "socialism with Chinese characteristics" that beckoned foreign advisors and investors. Chinese openness led to substantial foreign aid, investments, and trade, with Japan taking the lead.

Simultaneously, with the Cold War doctrine of containment shattered by the loss of the war in Vietnam and the U.S. economy shredded by rising budget deficits, a ballooning public debt, and a dwindling manufacturing base, U.S. protectionism took early root. Japan, once seen by U.S. policy-makers as a critical alliance partner posing minimal market challenges, transitioned into a full-on economic threat. Previously welcomed Japanese products confronted nationalistic pushback, one manifestation of which was a realignment of currency rates, through the 1971 breakdown of Bretton Woods and the 1985 Plaza Accord. Both resulted in a vastly stronger Japanese yen and a tsunami of outgoing investments by Japanese companies into regional production networks across East and Southeast Asia, as well as into the United States.

Nevertheless, despite the United States' selective protectionism, U.S. and Japanese military forces continued to collaborate closely, expanding the roles and missions of the Japan Self-Defense Forces (SDF), enhancing the inter-operability of their militaries and resulting in SDF missions to the Iraq and Afghanistan theatres. As well, Japanese corporations invested heavily in numerous industries within the United States, while numerous Japanese-U.S. business ties thrived. Meanwhile, even though China's growth caromed forward, its military expenditures and overseas muscle flexing remained minimal. China projected an aura of "peaceful rise" as policy-makers increasingly aligned with global trade and financial institutions. As a most notable example, China made extensive domestic adjustments to its national economy as the price of admission to join the World Trade Organization (WTO) in 2001. Thus, even as Japan's economics and security interests diverged, the tensions between them remained latent and muted until well into the 2000s.

Japan's economic-security dilemma began crystalizing further with the Persian Gulf War (1991). Seeking to retain its strict adherence to "defensive defence," Japan rejected U.S. requests to send SDF forces to support the U.S. counter-invasion, even as it supplied an astonishing US\$13B to support the mission. However, U.S. officials made it clear that the United States would no longer accept Japan as a serious alliance partner without a corresponding Japanese willingness to do more militarily.

For Japan, 9/11 provided the ideal opportunity to bolster its military credentials with the United States. Since 9/11, with increasing tempo, Japan has expanded its military activities. It met U.S. requests for greater burden sharing in the alliance, among other things, by sending SDF forces to support the U.S. military in Afghanistan and Iraq. Japan expanded its lines of maritime self-defence. It adopted theatre missile defence. It began regular "2x2" meetings of defence and foreign ministers from both countries. It has participated in the U.S.-led proliferation security initiative (PSI) as well as multilateral military exercises including Cobra Gold and the India-led Malabar maritime exercises. It has boosted relations with Taiwan while explicitly labelling China and the DPRK to be security challengers. The once-marginalized Defense Agency gained upgraded status as a ministry. A reinterpretation of Article 9 allowed Japan to advance toward

“collective security,” and once-declining defence budgets have moved steadily upward since 2012.

Yet, Japan’s military enhancements did little to ensure the full commitment of the United States to the Asian region and to economic, as well as security, engagement with Japan. Most specifically, the George W. Bush administration, deeply enmeshed in Iraq and Afghanistan, reduced U.S. attention to economics as a tool of foreign policy, scorned multilateralism, and minimized the U.S. commitment to Asian regional institutions. Japan’s economic interdependence with the Asian region and its growing number of regional multilateral institutions received little encouragement during the Bush years.

The global financial crisis (2008–2009) proved another jarring inflection point as the global economy went into freefall, destroying any belief, certainly in Asia, about the U.S. financial world’s mantra of self-regulating markets while belying claims about the superiority of U.S. financial institutions. Within China, convictions rose among scholars and policy-makers that the United States’ post-Cold War hegemony had peaked and that the United States was in decline.

As Chinese macro-economic trade and investment continued apace, a more authoritarian Communist Party emerged under Xi Jinping. His government made a number of more assertive advances in the East China Sea and South China Sea and began weaponizing national economic muscle. China curtailed exports of critical rare earth material to Japan and unleashed violent demonstrations against Japanese investments and products in China in response to the escalating Senkaku/Diaoyu dispute. Economically, China initiated new institutions such as the Belt and Road Initiative (BRI) and the Asian Infrastructure Investment Bank (AIIB) as bodies outside existing global institutions such as the IMF, the ADB, and the World Bank. It also took the lead in forging the Shanghai Cooperation Organisation (SCO), which created security linkages among China, Russia, and four Central Asia Republics that critics branded an “anti-NATO.”

## **Reconciling Competing Needs**

All these developments created ever more daunting tensions for Japanese policy-makers. Was it to be Asia versus the United States? What about economics versus security? The Trans-Pacific Partnership (TPP), however, initially appeared to offer a potential resolution to those tensions. Designed to include 12 countries accounting for 40 percent of the world’s trade, the TPP held out the promise of a regionally resurgent United States that would reaffirm its commitment to East Asia and the global liberal order while simultaneously presenting a forceful and multilateral challenge to Chinese mercantilism domestically and its expanding economic pre-eminence in East Asia. After months of indecision, Japan joined TPP negotiations, ultimately becoming an outspoken advocate.

That vision vanished under the Trump administration. Trump withdrew the United States from the TPP as part of a broader assault on global institutions such as the WTO, the WHO, and the

IMF. It opted out of multilateral agreements such as the Iran nuclear deal and the Paris Climate Accord in favour of a series of trade wars that, among other things, raised tariffs on exports from Japan and a number of other U.S. allies under the dubious justification of “national security.” As well, behind a drumbeat of Trumpian tweets, the White House unleashed a sequence of attacks on long-standing democratic allies (including Japan) while lavishing praise on, and advancing the goals of, dictators who posed genuine military threats.

It took Japanese policy-makers some time to find their policy-making footing. However, shrugging off initial anxieties that the absence of the United States would mean the death of the TPP, Japan joined with Australia and New Zealand to lead the 11 remaining members in advancing a second-best countermeasure. The newly named Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP, or TPP-11) went into effect on December 30, 2018, with expectations that other regional countries would welcome the opportunity to join (while not foreclosing the collective hope that the United States would rejoin). In addition, Japan continued to advance a series of bilateral trade pacts, plus signing a trade deal with the European Union and continuing negotiations for the Regional Comprehensive Economic Partnership (RCEP). All telegraphed Japan’s commitment to regional and global liberal institutions. At the same time, Japan has also sought to counter China’s regional economic investment initiatives by advancing its own multi-billion-dollar “Connectivity Initiative,” which emphasizes sustainable infrastructure and construction projects across Asia.

As it put in place various institutions that might expand Japan’s regional economic influence as an alternative to China’s growing reach, Japan also sought to reduce tensions with China. The two countries, the world’s second- and third-largest economies, continue to share deep economic ties, despite their frequent security mistrust. China remains Japan’s largest trading partner. Many Japanese technology companies, particularly those making industrial robots, semiconductors, and electronic parts, rely heavily on sales to China. Cognizant of those ties, both countries softened their prior confrontational rhetoric over the Senkaku/Diaoyu Islands controversy, conservative domestic politics in Japan, and chauvinistic netizens in China. Japanese direct investment in China leapt in the second half of 2018, the first major surge in such foreign direct investment since 2005. Further, on October 25, 2018, Prime Minister Abe Shinzo and President Xi Jinping began a three-day meeting that marked the first summit between leaders of the two countries in eight years. Among other things, companies from Japan and China signed agreements to cooperate in third countries for 52 joint projects, effectively pushing back against U.S. pressures for its allies to avoid participation in China’s BRI. Many AIIB projects entered into joint funding by Japan’s favoured regional financial institution, the ADB, as Japan sought to work with China on high-quality investment projects across the region.

At the same time, Japanese leaders continue to work hard to placate Trump. If the United States no longer enjoys the hegemonic singularity of the past, the U.S. dollar is still the world’s premier currency. The WTO and the IMF still function according to rules that the United States helped

generate. The chief of the World Bank is always from the United States. The U.S.-Japan Security Alliance remains in place and military-to-military interactions between the Pentagon and the SDF have a tenacious root structure and common perceptions of security challenges that keep the two militaries close despite bilateral economic frictions. Consequently, Japan agreed to a one-sided bilateral trade agreement that provided a key Trump electoral group, U.S. farmers, with virtually equivalent access to Japan's market as Japan's TPP partners. Japan got virtually nothing in return except the temporary conciliation of Donald Trump.

Where the United States and Japan came most into accord was in hard security. The United States, in a variety of Department of Defense documents, has embraced Abe Shinzo's signature concept of a Free and Open Indo-Pacific. Indeed, Japan, Australia, and India are in active discussions about the possibility of creating "the Quad," a co-operative four-party security arrangement among themselves and with the United States.

Clearly, Japan is not being passive in the face of Chinese assertiveness or the Trump administration's mercurial zigzags, nor allowing either country to drag Japan out of the liberal trading order. The deep institutionalization of regional production networks and multilateral institutions has contributed powerfully to decades of peace and prosperity across the Asia Pacific and moved Japan, along with a substantial number of other regional states, to welcome the global liberal order. The United States' moves to raise tariffs, to retreat to unilateralism, and to brand China as an existential threat have not obliterated that history, nor the commitments of Japan—along with many regimes across the region—to retain free trade, multilateral co-operation, and continued, if hedged, engagement with China. It is a familiar adage across East Asia that "China will always be here; the United States has the freedom to leave."

## **Policy Recommendations**

How devastating and long-lasting are current trends likely to be? Three decades of peace and prosperity across the Asia Pacific, from roughly 1980 to 2008, make it tempting to dismiss the present tensions as unfortunate, but reversible, deviations from the deeply entrenched set of regional developments marked by multilateral engagement, regional production networks, low levels of state-to-state conflicts, and rising economic globalization. Such sanguinity, however, requires a conviction that recent damage is not structural and permanent and that the actions by Japan, along with a number of other regional regimes, can retain current advantages until the return of less confrontational relations between the United States and China. Yet, many recent disruptive geopolitical tensions have ancient roots, and policy-makers in the United States and China show few signs of accommodation. The longer their inward-facing actions continue to shred the liberal and regional economic order, the more likely it is that such actions will have deleterious consequences across the Asia Pacific that will be difficult to reverse, however diligent the pushback from Japan and other regional states.

Nonetheless, Japanese policy-makers retain substantial agency to channel current pressures. They would be wise to continue engaging with the United States to the extent possible, playing down bilateral trade tensions in favour of multilateral co-operation, even if limited to the military arena. At the same time, Japanese policy-makers would be wise to continue taking advantage of national economic strengths to simultaneously engage and check China, working to advance arrangements that allow Japan and China to co-operate in regional trade arrangements and infrastructural development. However, the overarching goal for Japan must be to avoid allowing China-U.S. tensions to force it into zero-sum decisions. Surely, if U.S. and Chinese trajectories continue without alteration, the damage to Japan, the Asia Pacific order, and the larger global liberal order will surely be severe, and policy-making choices in Japan will become ever more costly.