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Expanding the US-Japan economic security partnership: Engaging allies and partners

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Executive summary

Economic security has emerged as a national security priority in Tokyo and Washington as both confront the challenges posed by China's civil-military fusion and economic coercion. Japanese and US policymakers have turned to industrial policy to support domestic manufacturing and research in strategic sectors like semiconductors. They have sought to stem leading-edge technology flows to China by imposing export restrictions and other measures while seeking to build more reliable, resilient supply chains for critical minerals and other key inputs. The alignment of Tokyo and Washington on their strategic views of China and the convergence of their economic security priorities has created a new era of alliance cooperation on these issues.

The United States and Japan have made remarkable progress in this economic security partnership. However, the real test lies in whether this partnership can serve as a building block for broader cooperation with like-minded allies and partners. Achieving shared goals for economic security will require close alignment with other advanced economies to forge collective economic resilience and a coordinated approach to protecting critical and emerging technologies. Washington and Tokyo should build upon existing economic security discussions in the Group of Seven (G7) framework to launch "G7 Plus" agreements on economic coercion and export controls.

Success in strategic competition with China also requires a robust strategy of economic engagement with Indo-Pacific countries, particularly in Southeast Asia, where China's economic influence rises. The United States and Japan should intensify efforts to deliver an economic growth agenda to regional countries increasingly finding their economic options limited to China. They can leverage Japan's strengths as a regional leader in infrastructure development and trade to realize the vision laid out in the Indo-Pacific Economic Framework for Prosperity and the Philippines' Luzon Economic Corridor. They should also revisit discussions on market access with key Indo-Pacific partners. Sectoral trade deals in critical minerals and other strategic sectors would help build resilient, diversified supply chains, signaling that the United States and Japan remain open to mutually beneficial economic linkages.

Economic security comes into focus

Economic security has taken center stage in the foreign and economic policies of the United States and Japan as strategic competition with China has intensified. Economic security has been reframed as a core component of national security in Washington and Tokyo, and both governments have turned to large-scale industrial policy to strengthen strategic sectors and supply chains.

The United States

For the United States, China's rise as a near-peer competitor has created an unprecedented challenge, one different from the Cold War. China's emergence as an economic and technological powerhouse, fueled by the Chinese Communist Party's (CCP's) development and acquisition of advanced technology and fusing of military and civilian capabilities, has put technological competition at the center of geostrategic rivalry.

The Trump administration first signaled a strategic shift in its 2017 National Security Strategy, which declared "economic security is national security."[1] The Trump administration primarily viewed economic security through the lens of trade protection, pursued through tariffs imposed on Chinese-manufactured imports, aluminum, and steel. However, concerns over technology came to the fore in 2019 when the Trump administration banned Chinese telecom giant Huawei from doing business with US companies, severing access to US semiconductor technology.[2]

The Biden administration went further with a comprehensive approach to economic security, including defensive actions to prevent advanced technology from getting into the hands of China's military and offensive actions to promote domestic economic strength and innovation. Defensively, the administration revised export controls on semiconductor technology to restrict China's access to semiconductor chips, technology, and manufacturing equipment. This includes restrictions on outbound US investment in the semiconductor, quantum information, and artificial intelligence (AI) sectors. On the offensive side, the CHIPS and Science Act offers billions of dollars in subsidies to onshore domestic manufacturing of semiconductors and research and development (R&D) in leading-edge technologies.[3] Additional incentives have been provided by the Inflation Reduction Act (IRA), which boosts manufacturing and supply chains in electric vehicles (EVs), batteries, and other green technologies.[4]

A major IRA provision is a $7,500 consumer tax credit for EVs made with batteries containing critical minerals mined or processed in the United States or a free trade agreement (FTA) partner. The EV subsidy is designed to stimulate domestic EV demand and investment to better compete with China. However, countries that do not have FTAs with the United States would be excluded, even close allies and partners like Japan, the European Union (EU), and most of Southeast Asia.

The EV subsidy in the IRA highlights the tension between the impulse to onshore and re-shore domestic manufacturing in critical sectors and the need to build collective resilience against Chinese economic coercion by securing stable supply chains with regional allies and partners. In an April 22 speech at the Atlantic Council, US Treasury Secretary Janet L. Yellen touted "friend-shoring" of supply chains among "trusted countries" as the best way to counter the challenge of countries using "their market position in key raw materials, technologies, or products" to cause economic disruption and "exercise unwanted geopolitical leverage."[5] Still, the exclusionary EV tax credit, as well as continued tariffs targeting aluminum and steel, has caused consternation among allies about the protectionist drift of US industrial policy.

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1 Trump White House Archives, *National Security Strategy of the United States of America*, White House, December 2017, https://trumpwhitehouse.archives.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf.

2 David Shepardson and Karen Freifeld, "Trump administration hits China's Huawei with one-two punch," Reuters, May 16, 2019, https://www.reuters.com/article/business/trump-administration-hits-chinas-huawei-with-one-two-punch-idUSKCN1SL2QX/#:~:text=The%20United%20States%20has%20been,another%20Chinese%20provider%2C%20ZTE%20Corp.

3 The White House, "FACT SHEET: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China," August 9, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/.

4 Inflation Reduction Act of 2022, H.R. 5376 — 117th Congress (2021-2022), https://www.congress.gov/bill/117th-congress/house-bill/5376/text.

5 Atlantic Council, "Transcript: US Treasury Secretary Janet Yellen on the next steps for Russia sanctions and 'friend-shoring' supply chains," *New Atlanticist*, April 13, 2022, https://www.atlanticcouncil.org/news/transcripts/transcript-us-treasury-secretary-janet-yellen-on-the-next-steps-for-russia-sanctions-and-friend-shoring-supply-chains/.

Japan

Japan has long viewed economic resilience as central to national security. Japan's lack of natural resources has made it vulnerable to supply chain disruptions, and its postwar commitment to pacifism made economic diplomacy central to Tokyo's foreign policy. In the early postwar years, the Japanese government interlinked its industrial policy with its economic diplomacy abroad by helping secure market access and supply chain linkages for Japan's domestic manufacturing industry.

Tokyo's focus on economic security came to the fore in 2010 when tensions flared with Beijing over the Senkaku Islands, and China cut off rare earth metal exports to Japan. China's economic coercion served as a wake-up call to Japan about the risks of overdependence on China for critical minerals.[6] The incident prompted Japan to reduce its vulnerability by diversifying supply chains, promoting recycling, and developing alternative technologies. As a result, Japan's dependence on China for rare earth elements dropped from nearly 90 percent at the time of the 2010 incident to 60 percent in 2023.[7]

The Covid-19 pandemic further exposed vulnerabilities in supply chains heavily sourced from China. Shortages of critical goods like semiconductors, electronic components, pharmaceuticals, and medical supplies heavily impacted Japan, the United States, and most other countries, prompting governments to look more broadly at de-risking and diversifying supply chains away from China.[8]

Japan became the global pacesetter on economic security in the wake of these challenges. Japan reorganized its government bureaucracy to elevate economic security in decision-making, establishing an economic security division within the national security secretariat to coordinate policy across a range of newly created units. One of Japanese Prime Minister Fumio Kishida's first actions upon taking office in October 2021 was to create a new minister for economic security. His government enacted economic security legislation in May 2022 focused on reducing supply chain vulnerabilities, promoting and protecting critical technologies, and securing critical infrastructure. Japan's new National Security Strategy (NSS), released in late 2022, identified "supply chain vulnerabilities, increasing threats to critical infrastructures, and leadership struggles over advanced technologies" as core areas of concern, calling for Japan to "curb excessive dependence on specific countries."[9]

The renewed focus on economic security has led to a renaissance in Japan's industrial policy. The government is heavily investing in the domestic semiconductor industry and other strategic sectors to boost domestic manufacturing, strengthen supply chains, and spur new technological development. In semiconductors, the Ministry of Economy, Trade and Industry (METI) is using generous subsidies to back two major initiatives—a highly ambitious venture called Rapidus aimed at leapfrogging technology by developing next-generation 2 nanometer (nm) chips and an effort to attract investment by Taiwan's semiconductor giant TSMC to launch large-scale legacy chip manufacturing in Kyushu.[10]

METI facilitated the formation of Rapidus in 2022 with the backing of eight major Japanese companies (Toyota, Sony, NEC, Denso, NTT, Kioxia, SoftBank, and MUFG Bank) and has provided it subsidies totaling nearly one trillion yen (about $6.3 billion) so far.[11] Its goal is to develop the manufacturing technology for and launch mass production of 2 nm logic chips by the end of 2027, which would widen the technological gap with China. Meanwhile, the Kyushu project has shown early signs of success. TSMC formed a joint venture with Sony and Denso under the name Japan Advanced Semiconductor Manufacturing (JASM) and built the first fab in under two years, opening in February 2024. Plans were immediately announced for JASM to build a second fab in Kyushu, with additional massive subsidies provided by METI and Toyota added as a new partner.

6 Keith Bradsher, "Amid Tension, China Blocks Vital Exports to Japan," *New York Times, September 22, 2010,* https://www.nytimes.com/2010/09/23/business/global/23rare.html.

7 Tatsuya Terazawa, "How Japan solved its rare earth minerals dependency issue," World Economic Forum, October 13, 2023, https://www.weforum.org/agenda/2023/10/japan-rare-earth-minerals/; and Tatsuya Terazawa, "Chairman's Message: 'The rare earths embargo of 2010 and its lessons,'" Institute of Energy Economics, Japan, October 2023, https://eneken.ieej.or.jp/en/chairmans-message/chairmans-message_202310.html.

8 Shino Watanabe, "Japan's Initiatives to Secure Supply Chains and Its Key Challenges," Italian Institute for International Political Studies, March 17, 2022, https://www.ispionline.it/en/publication/japans-initiatives-secure-supply-chains-and-its-key-challenges-34186.

9 Cabinet Secretariat, *National Security Strategy of Japan, December 2022,* https://www.cas.go.jp/jp/siryou/221216anzenhoshou/nss-e.pdf.

10 Mireya Solís and Mathieu Duchâtel, "The renaissance of the Japanese semiconductor industry," Brookings Institution, June 3, 2024, https://www.brookings.edu/articles/the-renaissance-of-the-japanese-semiconductor-industry/.

11 Reuters, "Japan approves $3.9 billion in subsidies for chipmaker Rapidus," April 1, 2024, https://www.reuters.com/technology/japan-approves-39-billion-subsidies-chipmaker-rapidus-2024-04-02/.

Figure 1 | Support to the semiconductor industry

	Total spending	As a percentage of GDP
Japan	3.9 trillion yen (3 years)	0.71%
United States	7.1 trillion yen (5 years)	0.21%
Germany	2.5 trillion yen (5 years)	0.41%
France	700 billion yen (5 years)	0.2%

Source: Kazuhiro Ogawa, "Japan outspends U.S., Germany on chip subsidies as share of GDP," Nikkei Asia, April 10, 2024, https://asia.nikkei.com/Business/Tech/Semiconductors/Japan-outspends-U.S.-Germany-on-chip-subsidies-as-share-of-GDP.

Both Japan and the United States are providing high-level support for the semiconductor industry. According to Nikkei, Japan is spending a total of 3.9 trillion yen ($25.7 billion) over three years from 2022–25, which amounts to 0.71 percent of Japan's GDP.[12] The United States is planning to spend nearly twice that amount over five years (7.1 trillion yen, or $46.8 billion). However, this represents a smaller share (0.21 percent) of US GDP. By comparison, Germany's state support for semiconductors amounts to 0.41 percent of its GDP, while France is spending the equivalent of 0.2 percent.

US-Japan bilateral cooperation on economic security

The convergence of strategic views on China and the elevation of economic security as a paramount concern in both Washington and Tokyo have fundamentally reshaped alliance cooperation. With defense cooperation at an all-time high, economic security has emerged as a second alliance focal point, fulfilling the vision of "economic collaboration" between the two countries in Article II of the US-Japan Mutual Security Treaty.[13] Anchored by a new high-level economic dialogue, Tokyo and Washington are working closely to promote and protect critical technologies; strengthen supply chains in semiconductors, EV batteries, and critical minerals; and coordinate industrial policies.

Launching 2+2 economic dialogue

The US-Japan Economic Policy Consultative Committee (EPCC), the "Economic 2+2," was launched in July 2022 to ensure high-level alliance attention on economic security-related issues. The EPCC is convened by the US secretaries of state and commerce with Japanese counterparts from the Ministry of Foreign Affairs and METI. The Economic 2+2 is an umbrella for consulting and coordinating policies on a range of issues, from diversifying supply chains in strategic sectors to collaborating on advanced semiconductor R&D to coordinating export controls.

Semiconductors

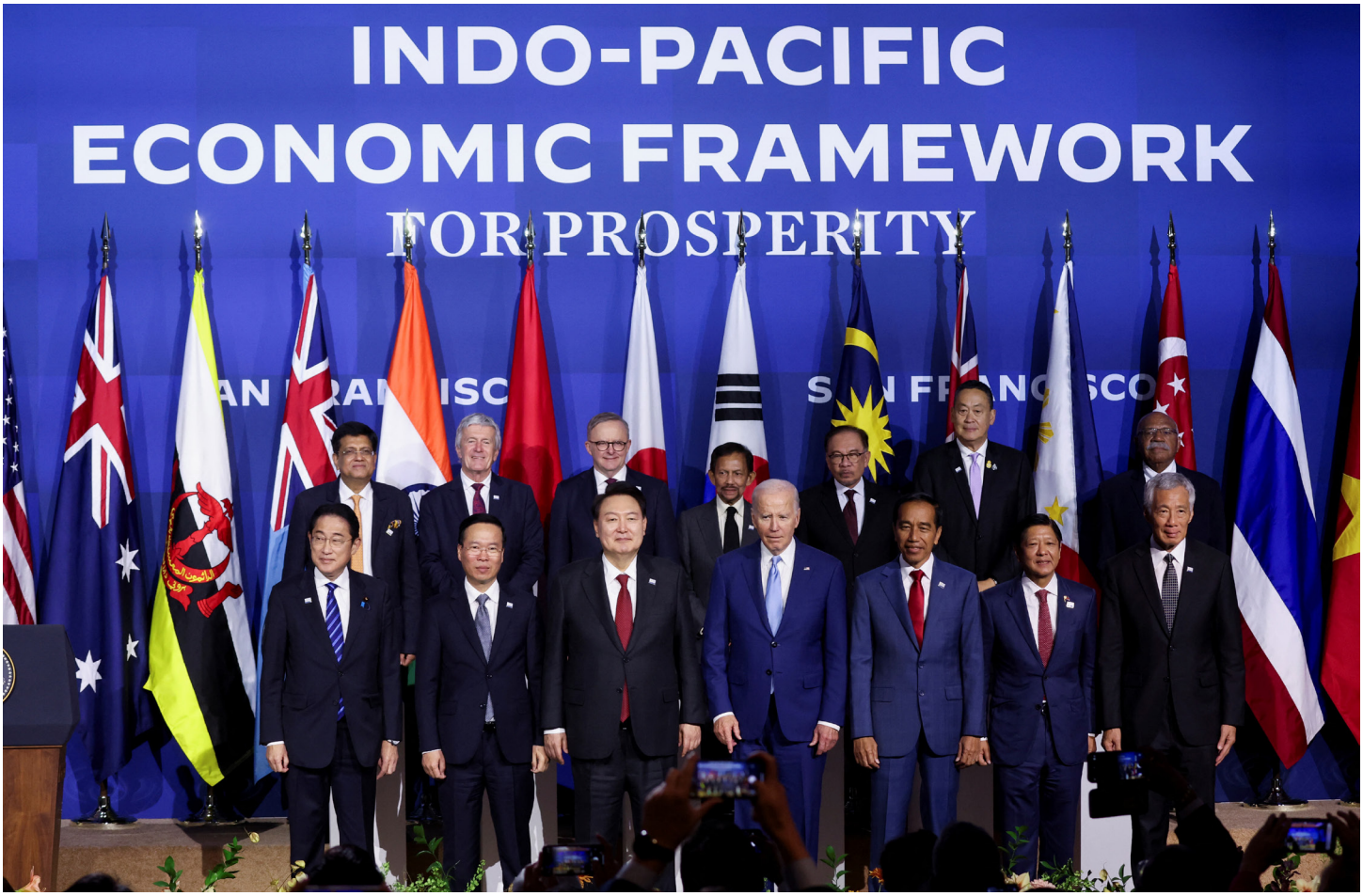
Semiconductors are a central focus of bilateral cooperation as the United States and Japan work to build stable supply chains in semiconductors and to maintain their positions at the leading edge of this critical technology. In May 2022, Washington and Tokyo pledged to "dramatically speed up" cooperation in developing next-generation semiconductors, and at the Economic 2+2 meeting in July 2022, the two countries announced plans to establish a joint research center for new chips.[14] At the July meeting, US Secretary of Commerce Gina Raimondo called semiconductors "the linchpin of our economic and national security" and said that collaboration on advanced chips was a top priority.[15] Government coordination has spurred collaboration in the private sector, with Rapidus

12 Kazuhiro Ogawa, "Japan outspends U.S., Germany on chip subsidies as share of GDP," *Nikkei Asia, April 10, 2024,* https://asia.nikkei.com/Business/Tech/Semiconductors/Japan-outspends-U.S.-Germany-on-chip-subsidies-as-share-of-GDP.

13 Ministry of Foreign Affairs of Japan, "Japan-U.S. Security Treaty," accessed September 8, 2024, https://www.mofa.go.jp/region/n-america/us/q&a/ref/1.html.

14 Simon Lewis and David Brunnstrom, "U.S., Japan to cooperate on semiconductors as part of new economic dialogue," Reuters, July 30, 2022, https://www.reuters.com/technology/us-japan-set-agree-joint-research-semiconductors-media-2022-07-29/.

15 Ibid.



Indo-Pacific Economic Framework (IPEF) leaders pose for a family photo at the Asia-Pacific Economic Cooperation (APEC) CEO summit in San Francisco on November 16, 2023. Credit: REUTERS/Brittany Hosea-Small.

and IBM announcing strategic partnerships on developing and putting into production 2 nm chip technology, and more recently on advanced chiplet packaging.[16]

Coordination on export controls

The sweeping new export controls established by the Biden administration in October 2022 restricted Chinese access to US technologies needed to produce advanced semiconductor chips used for supercomputing, AI, and advanced military capabilities.[17] Japan and the Netherlands are also major producers of manufacturing equipment used for high-end chips. So, for the export controls to be effective, similar restrictions would need to be placed by those governments to prevent their companies from backfilling the technology through exports to China. In March 2023, Japan announced its own regulatory framework for semiconductor-related exports, adding twenty-three types of equipment used in high-end chip manufacturing to its control list.[18] The

16 Tim Kelly and Jane Lee, "IBM partners with Japan's Rapidus in bid to manufacture advanced chips," Reuters, December 12, 2022, https://www.reuters.com/technology/ibm-partners-with-new-japanese-chip-maker-rapidus-make-advanced-chips-2022-12-13/.

17 Bureau of Industry and Security, Department of Commerce, "Commerce Implements New Export Controls on Advanced Computing and Semiconductor Manufacturing Items to the People's Republic of China (PRC)," press release, October 7, 2022, https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3158-2022-10-07-bis-press-release-advanced-computing-and-semiconductor-manufacturing-controls-final/file.

18 Takashi Funakoshi and Kanako Tanaka, "Japan rallies for U.S. call to curb exports of chip gear to China," *Asahi Shimbun*, July 23, 2023, https://www.asahi.com/ajw/articles/14963732.

Netherlands followed suit with its own updated controls.[19] This coordination among the three major players in high-end semiconductor technology is an important step toward a broader coalition of like-minded partners to align technology export policies beyond current multilateral arrangements.

However, gaps in US-Japan export control policies remain and could cause friction. Washington is concerned about Chinese manufacturers producing advanced chips using manufacturing equipment from Japanese and Dutch firms stockpiled before the new restrictions were put in place and has asked Japan to add restrictions on equipment inspection and maintenance services by Japanese firms, aligning with US restrictions.[20] This would require a major overhaul of Japan's export controls, which currently only prohibit cross-border transfer of technology rather than provision of services provided by Japanese engineers and firms.

The biggest obstacle to closer alignment on export controls is Japan's concern about economic retaliation by China. Although Japan has reduced its dependence on China for critical minerals, Japanese industry remains vulnerable to a Chinese cutoff of critical mineral exports. China demonstrated its leverage in the wake of the new export controls put in place by the US, Japanese, and Dutch governments by curbing its exports of gallium and germanium.[21] Japan is particularly sensitive to the embargo of gallium, which is used in semiconductors, mobile phones, LEDs, and LCDs. Although recycling efforts have increased domestic supply, Japan relies on China for nearly 70 percent of gallium imports.[22] Wei Jianguo, a former Chinese vice minister of commerce, said China has "more tools" to respond to export controls and warned that the restrictions on gallium and germanium are "just the beginning of a counterattack."[23] This looming threat makes the Japanese government cautious about imposing tougher actions on technology exports, even as Washington continues to push its allies to curb semiconductor technology exports to China.[24]

Electric vehicle supply chains

When the IRA became law in August 2022, the United States and Japan quickly set about negotiating an arrangement enabling Japan to qualify for consumer tax credits for EVs reserved for FTA partners. In March 2023, the two countries signed a critical minerals agreement (CMA) that covers the five key minerals used in EV battery production—cobalt, graphite, lithium, manganese, and nickel. Although Japan is not a large source of these critical minerals, it has related capabilities, including EV battery production and mineral processing. In 2023, Japan was the tenth-largest source of US imports of these five critical minerals, and it plans to mine recently discovered seabed deposits of cobalt and nickel off Okinawa.[25]

The CMA commits the two countries to allow bilateral free trade in the five critical minerals and to cooperate on building sustainable and resilient critical mineral supply chains. According to subsequent guidance from the US Treasury Department, Japanese-sourced critical minerals would count toward the content requirements for EV batteries. By clearing the way to use critical mineral inputs from Japan, the CMA enabled Japanese auto manufacturers to ramp up plans for producing EVs and EV batteries in North American factories.[26] Toyota has committed nearly $14 billion for an EV battery plant in North Carolina, while Panasonic is investing $4 billion in its second major EV battery plant in the United States. Meanwhile, Honda has announced plans to invest $11 billion in EV manufacturing in Canada.

19 Toby Sterling, "Dutch curb chip equipment exports, drawing Chinese ire," Reuters, June 30, 2023, https://www.reuters.com/technology/amid-us-pressure-dutch-announce-new-chip-equipment-export-rules-2023-06-30/.

20 Alexandra Alper and Karen Freifeld, "US urges allies to bar firms from servicing key chipmaking tools for China," Reuters, March 27, 2024, https://www.reuters.com/technology/us-is-urging-allies-bar-firms-servicing-key-chipmaking-tools-china-2024-03-27/.

21 Hanna Ziady and Xiaofei Xu, "China hits back in the chip war, imposing export curbs on crucial raw materials," CNN, July 3, 2023, https://www.cnn.com/2023/07/03/business/germanium-gallium-china-export-restrictions/index.html.

22 NHK World-Japan, "China's curbs on rare metal exports may pose risk to Japan manufacturing," August 1, 2023, https://www3.nhk.or.jp/nhkworld/en/news/backstories/2629/.

23 Ma Si, "Former vice-minister of commerce: China has more tools for countermeasures against US export controls," *China Daily*, July 5, 2023, https://www.chinadaily.com.cn/a/202307/05/WS64a4ca73a310bf8a75d6d545.html.

24 Ana Swanson, "U.S. Vies With Allies and Industry to Tighten China Tech Controls," *New York Times*, August 9, 2024, https://www.nytimes.com/2024/08/09/business/economy/china-us-chip-semiconductors.html?searchResultPosition=8.

25 Kyla H. Kitamura, "U.S.-Japan Critical Minerals Agreement," Congressional Research Service, updated May 20, 2024, https://crsreports.congress.gov/product/pdf/IF/IF12517.

26 Rintaro Tobita and Shizuka Tanabe, "U.S. EV tax break leaves out imports in blow to Japanese, European autos," *Nikkei Asia*, March 31, 2023, https://asia.nikkei.com/Business/Automobiles/U.S.-EV-tax-break-leaves-out-imports-in-blow-to-Japanese-European-autos.

The US-Japan CMA was initially seen as a template for CMAs with other countries.[27] Soon after the US-Japan deal was signed, Washington launched negotiations with the EU and the United Kingdom while several Southeast Asian countries expressed a strong interest in a similar agreement. However, congressional criticism of the US-Japan CMA appears to have dampened interest in concluding these deals. Congressional concerns focused on the labor and environmental impact of the critical minerals sector and Chinese investment in some overseas mining and processing. No deals have concluded more than a year after the EU and UK negotiations were launched.

Strengthening critical mineral supply chains with third countries

The United States and Japan have taken somewhat different approaches to strengthening critical mineral supply chains. Washington has taken a multilateral approach, launching the Mineral Security Partnership (MSP), a fifteen-country forum seeking to diversify critical mineral supply chains by engaging with the governments of resource-rich host countries on projects with high environmental, labor, and governance standards. Japan is an MSP member but has been more interested in a targeted approach. Japan sought coordination with the United States to work jointly on identifying and supporting projects in third countries with reserves of critical minerals most vulnerable to Chinese economic coercion. Gallium in particular has been a focus of bilateral discussions under the umbrella of the Economic 2+2 framework.

Aligning the Group of Seven and engaging on an Indo-Pacific economic agenda

Bilateral economic cooperation is critical for addressing economic security challenges, but the key to long-term success in achieving economic security goals lies in the ability to align like-minded allies and partners for collective action. Japan has led the way via Group of Seven (G7) discussions, resulting in an economic security framework that can be built upon to coordinate policies and mitigate vulnerabilities more effectively.

However, an effective strategy for countering the strategic challenges posed by China requires a positive agenda of economic engagement with the Indo-Pacific region—particularly Southeast Asia, where geostrategic competition is most intense. Recent surveys of Southeast Asian strategic elites conducted by the ISEAS-Yusof Ishak Institute show increasing concern about China's growing economic influence, with more than a third of respondents saying they fear that China would use economic tools to punish their country's foreign policy choices.[28] Japan has stepped up its game to try to meet the challenge by playing a leading role in forging trade agreements with partners in the region, including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP), and continuing to play a leading role in infrastructure development in Southeast Asia. However, the United States has lagged behind. After the January 2017 US withdrawal from the Trans-Pacific Partnership, the predecessor to the CPTPP, and the new distaste in Washington for deals involving market access, many in the region fear that US economic influence is rapidly declining.[29] The Biden administration sought to fill the void with two new economic approaches: building a cooperative framework in key areas of commerce and spurring infrastructure development in an economic corridor in the Philippines.

Japan takes the lead in the G7

In 2023, Japan used its G7 presidency to focus the G7's agenda for the first time on economic security. Japan's leadership was especially helpful in defining "economic security," establishing principles on economic coercion and "resilient and reliable supply chains," and developing a framework for coordinated action on specific policies. The May 2023 G7 Summit in Hiroshima produced a Leaders' Statement on economic resilience and economic security, defining economic coercion as incidents "that seek to exploit economic vulnerabilities and dependencies and undermine the foreign and

27 David E. Bond et al., "Will the United States' New Critical Minerals Agreements Shape Electric Vehicle Investments?" White & Case, June 28, 2023, https://www.whitecase.com/insight-alert/will-united-states-new-critical-minerals-agreements-shape-electric-vehicle.

28 Sharon Seah et al., *The State of Southeast Asia 2024 Survey Report*, ASEAN Studies Centre, ISEAS-Yusof Ishak Institute, April 2, 2024, https://www.iseas.edu.sg/wp-content/uploads/2024/03/The-State-of-SEA-2024.pdf.

29 The ISEAS-Yushok Ishak Institute annual surveys of Southeast Asian strategic elites show a steady decline in the perception of US economic influence. In 2024, only 14.3 percent of respondents saw the United States as the most influential economic power, well below China at 59.5 percent. China surpassed the United States for the first time as the preferred superpower in the region (50.5 percent for China versus 49.5 percent for the United States). Seah et al., *The State of Southeast Asia 2024*.

domestic policies and positions of G7 members as well as partners around the world."[30] The leaders expressed "serious concern" about the "disturbing rise in incidents of economic coercion" and "call[ed] on all countries to refrain from its use." The statement outlined seven areas for "ongoing strategic coordination," including building resilient supply chains, protecting critical infrastructure, preventing the leakage of sensitive technologies, and countering economic coercion. Notably, the G7 agreed on a "Coordination Platform on Economic Coercion" that will use early warning, information sharing, and consultation among members to facilitate "coordinated responses" to deter economic coercion and support targeted states.

The G7's position on economic coercion was subsequently endorsed by Australia, New Zealand, and the EU, while South Korea has endorsed the G7's principles on resilient and reliable supply chains.[31]

The United States launches the Indo-Pacific Economic Framework for Prosperity

US President Joe Biden unveiled the Indo-Pacific Economic Framework for Prosperity (IPEF) in 2022 with the aim of countering China's economic influence in the Indo-Pacific and signaling to the region that the United States remains committed to economic engagement despite its new reluctance to negotiate trade agreements.[32] Trade deals like the TPP that offer reciprocal market access have historically been the centerpiece of US economic statecraft, and have provided Washington with considerable economic influence based on the attractiveness of the large US domestic market. The rejection of TPP by then US president Donald Trump in 2017 and the rising political unpopularity of FTAs has foreclosed this traditional approach to trade deals in Washington, which in turn fuels skepticism among US regional partners about its commitment to counter China's growing economic influence.

The IPEF was framed as a new approach to trade, one that would forge cooperation and common rules in key areas of commerce across four pillars—trade, supply chains, clean energy, and anticorruption—without tying them to binding market access commitments. Without market access on the table, many countries were not eager to participate. Japan played a key role in helping persuade them to join. Biden launched the IPEF in Tokyo, with the United States and Japan joined by eleven other countries—Australia, Brunei, India, Indonesia, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Thailand, and Vietnam. Negotiations on the supply chain pillar were concluded relatively quickly, while agreements on the clean energy and anticorruption pillars were announced at the Asia-Pacific Economic Cooperation Summit in San Francisco in November 2023. However, the Biden administration indefinitely postponed discussions on the trade pillar, which included provisions on digital trade, labor protections, and the environment, due to concerns expressed by Democrats in Congress that "Big Tech" had too much influence over proposed rules.[33]

The failure of the trade pillar has made the IPEF a modest success at best.[34] On the positive side, the supply chain agreement is the first of its kind and off to an early start. It has established collaborative frameworks for sharing information on critical supplies and coordinating in the event of a supply chain disruption. This process-based approach may prove helpful in identifying supply chain vulnerabilities and improving communication and crisis response. Still, it remains an open question whether it can meaningfully shift market forces to diversify supply chains away from China. Meanwhile, China has trade deals like RCEP and tools like the Belt and Road Initiative

30 White House, "G7 Leaders' Statement on Economic Resilience and Economic Security," May 20, 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/05/20/g7-leaders-statement-on-economic-resilience-and-economic-security/#:~:text=G7%20Leaders'%20Statement%20on%20Economic%20Resilience%20and%20Economic%20.

31 Penny Wong, Minister of Foreign Affairs, Australia, "Joint Declaration Against Trade-Related Economic Coercion and Non-Market Policies and Practices," joint statement, June 9, 2023, https://www.foreignminister.gov.au/minister/penny-wong/media-release/joint-declaration-against-trade-related-economic-coercion-and-non-market-policies-and-practices; European Commission, "Joint Statement EU-US Trade and Technology Council of 31 May 2023 in Lulea, Sweden," May 31, 2023, ttps://perma.cc/2E3F-U2B8; and US Department of Commerce, "Joint Statement: Japan-Republic of Korea-United States Commerce and Industry Ministerial Meeting," press release, June 26, 2024, https://www.commerce.gov/news/press-releases/2024/06/joint-statement-japan-republic-korea-united-states-commerce-and.

32 US Commerce Secretary Gina Raimondo told reporters in May 2022 ahead of a launch event that the Indo-Pacific Economic Framework for Prosperity "marks an important turning point in restoring U.S. economic leadership in the region and presenting Indo-Pacific countries an alternative to China's approach to these critical issues." Peter Baker and Zolan Kanno-Youngs, "Biden to Begin New Asia-Pacific Economic Bloc With a Dozen Allies," *New York Times*, May 23, 2022, https://www.nytimes.com/2022/05/23/world/asia/biden-asian-pacific-bloc.html.

33 Brett Fortnam, "IPEF members finalizing parts of trade pillar; some digital pieces on hold," *World Trade Online*, *Inside US Trade*, October 6, 2023, https://insidetrade.com/daily-news/ipef-members-finalizing-parts-trade-pillar-some-digital-pieces-hold.

34 Chris Dixon and Bob Savic, "After APEC: Whither US Leadership on Trade?" *Diplomat*, December 15, 2023, https://thediplomat.com/2023/12/after-apec-whither-us-leadership-on-trade/.

(BRI) that directly incentivize supply chain integration and trade linkages with partner countries.[35] The IPEF pillars on clean energy and anticorruption rely heavily on the cooperation of the members, with flexibility built into the agreements and an emphasis on technical assistance and capacity building rather than fixed commitments to implement specific policies.[36]

Since the Biden administration chose to negotiate the IPEF as an executive agreement and did not seek congressional approval for the deal, the durability of the deal is unclear. Looming over all of the work to implement the IPEF agreements is the specter of the November US presidential election since Trump has pledged to "knock out" the IPEF on "day one" of a second Trump administration, calling it "even worse" than TPP.[37]

US-Japan-Philippines trilateral cooperation and the Luzon Economic Corridor

At their summit in Washington in April 2024, the leaders of the United States, Japan, and the Philippines announced ambitious plans for a Luzon Economic Corridor (LEC). This initiative will channel US and Japanese investment to support connectivity among ports in Subic Bay, Clark, Manila, and Batangas in the Philippines. In addition to infrastructure projects for rail, runway, and port upgrades, the LEC envisions high-impact investments to promote semiconductor and critical mineral supply chains as well as clean energy and agriculture. The LEC emerged from the first-ever US-Japan trilateral summit with a Southeast Asian partner as a signal that trilateral cooperation with Washington and Tokyo could yield tangible economic results for a country like the Philippines, not just security cooperation.

Billed as the first economic corridor in the Indo-Pacific region for the G7's flagship infrastructure initiative, the Partnership for Global Infrastructure and Investment, the LEC offers a model as well as a litmus test for US-Japan efforts to offer an alternative to China's BRI. For this to work, comparatively modest US-Japan government funding and financing will need to mobilize hefty private sector investment—about $100 billion over five to ten years.[38] Focused, sustained efforts and intensive government-private sector engagement among all three countries will be required to realize these goals.

Recommendations

The next steps for the US-Japan economic security partnership should focus on engaging like-minded allies and important Indo-Pacific partners on a shared agenda of economic security, resilience, and prosperity. To compete successfully against China, the United States and Japan should expand efforts to engage countries in Southeast Asia and the broader Indo-Pacific with a positive economic agenda that promotes mutual prosperity and tangible economic benefits through trade and investment linkages. This partnership should leverage Japan's unique strengths in this area—its leading role in quality infrastructure development, strong economic ties to countries in the region, and participation in regional trade frameworks.

Specifically, the United States and Japan should:

- *Follow through on the current agenda*, including finishing negotiations on the IPEF and ensuring the successful realization of the LEC.
- *Negotiate CMAs with key Indo-Pacific partners*.
- *Pursue a sectoral approach to trade in other areas*, including green technology, pharmaceuticals, and digital trade and AI, to restart the US trade agenda.
- *Build out the G7 agenda on economic coercion* to strengthen collective resilience with the inclusion of Australia and South Korea for a "G7 Plus."
- *Align "G7 Plus" countries on export controls* to create a new multilateral export control regime to replace the Wassenaar Arrangement.

35 Wendy Cutler and Clete Willems, "Jump-starting U.S. Trade and Economic Engagement in the Indo-Pacific," Asia Society Policy Institute, September 11, 2023, https://asiasociety.org/policy-institute/jump-starting-us-trade-and-economic-engagement-indo-pacific.

36 Jane Mellsop, "IPEF — Two Steps Forward, But One Important Step Still Missing," Asia Society Policy Institute, March 15, 2024, https://asiasociety.org/policy-institute/ipef-two-steps-forward-one-important-step-still-missing.

37 Nathan Layne, "Trump vows to kill Asia trade deal being pursued by Biden if elected," Reuters, November 18, 2023, https://www.reuters.com/world/us/trump-vows-kill-asia-trade-deal-being-pursued-by-biden-if-elected-2023-11-19/.

38 Alexis Romero, "Partnership forged for development of Luzon Economic Corridor," *Philippine Star*, April 13, 2024, https://www.philstar.com/headlines/2024/04/13/2347317/partnership-forged-development-luzon-economic-corridor; and Reuters, "Philippines eyes $100 billion in deals from summit with U.S., Japan," April 10, 2024, https://www.reuters.com/world/asia-pacific/philippines-eyes-100-bln-investment-deals-summit-with-us-japan-2024-04-11/#:~:text=%22We're%20talking%20about%20a,his%20U.S.%20and%20Japanese%20counterparts.

Follow through on the current agenda

Given the limited scope of the US trade and economic agenda in the Trump and Biden administrations, it is critical that the United States work with Japan to follow through on the initiatives launched in recent years. This includes ensuring successful outcomes for the LEC and concluding the trade pillar of the IPEF. While limited in scope compared to regional trade deals, they are bold in ambition and will require an intensive and focused effort to deliver on the vision and promised results.

The United States still has much to gain by negotiating the IPEF's trade pillar. Best-case, Congress could work with the next administration to sort out US priorities for "Big Tech" regulation at home and in the context of digital trade rules, allowing US negotiators to forge shared rules and standards limiting China's ability to interfere with data flows and source code. Even without digital provisions, a trade pillar agreement could be useful in promoting trade, investment, and supply chain integration by focusing on nontariff barriers and common standards. An agreement could also be expanded to include other trade-related areas like services, industrial standards, and intellectual property.[39]

Negotiate CMAs with key Indo-Pacific partners

One area that is ripe for economic cooperation is critical minerals. The United States and Japan have made diversifying and friend-shoring critical mineral supply chains a top priority in their economic security agenda. The United States has led two important efforts toward this goal—the IPEF supply chain agreement to facilitate information sharing and the MSP to boost investment in sustainable critical mineral supply chains. At the same time, the United States created a major obstacle to supply chain integration with key Indo-Pacific partners with the sourcing requirements for the EV tax credit in the IRA. Although South Korea and Australia have access to part of the tax credit through their FTAs with the United States and Japan is covered by the CMA, Southeast Asian partners are shut out.

Southeast Asia has abundant mineral resources in nickel, tin, bauxite, rare earth elements, cobalt, manganese, and graphite. Indonesia and the Philippines are the world's largest and second-largest producers of nickel, critical for lithium-ion batteries and EVs. Indonesia is also a major producer of tin and bauxite, and the Philippines is a leading producer of cobalt and copper.[40] Both countries have sought to expand mineral processing and boost investment in downstream sectors, with aspirations to become major players in EV battery supply chains.[41] Both Jakarta and Manila have approached Washington for CMAs similar to the one with Tokyo, so that they would be eligible for a portion of the $7,500 EV tax credit.[42] Vietnam and Malaysia are also important producers of critical minerals, with Vietnam ranking as the world's second-largest producer of bismuth and tungsten, while Malaysia produces processed rare earth elements.

The Biden administration has been reluctant to pursue CMAs with these partners due to concerns expressed in Congress about environmental and social impacts in the overseas critical minerals mining and processing sectors. Indonesia, which has been most vocal and persistent in its pursuit of a CMA, has faced opposition from a bipartisan group of senators who expressed concern about Indonesia's labor and environmental protections, as well as China's extensive presence in Indonesia's nickel industry.[43] But China remains dominant in critical mineral supply chains, including nickel and rare earth elements

39 Cutler and Willems, "Jump-starting U.S. Trade."

40 *ASEAN-IGF Minerals Cooperation: Scoping study on critical minerals supply chains in ASEAN* (Jakarta, Indonesia: Association of Southeast Asian Nations and Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development, May 2023), https://asean.org/book/asean-igf-minerals-cooperation-scoping-study-on-critical-minerals-supply-chains-in-asean/.

41 Mikhail Flores and Karen Lema, "Philippines eyes boost to nickel processing capacity," Reuters, May 10, 2024, https://www.reuters.com/markets/commodities/philippines-says-us-china-eyeing-mining-opportunities-especially-nickel-2024-05-10/; and Bloomberg News, "Philippine tycoon says bigger mining areas key to riding EV boom," Mining.com, February 19, 2024, https://www.mining.com/web/philippine-tycoon-says-bigger-mining-areas-key-to-riding-ev-boom/#:~:text=The%20Philippines%20and%20Indonesia%20are,EVs%20—%20to%20top%20market%20China.

42 Andy Home, "Indonesia's American EV dreams shunted into the slow lane," Reuters, November 20, 2023, https://www.reuters.com/markets/commodities/indonesias-american-ev-dreams-shunted-into-slow-lane-2023-11-20/; Cullen S. Hendrix, "The US should consider a critical minerals trade agreement with Indonesia," Peterson Institute for International Economics, November 16, 2023, https://www.piie.com/blogs/realtime-economics/us-should-consider-critical-minerals-trade-agreement-indonesia; Ken Moriyasu and Ramon Royandoyan, "First U.S.-Japan-Philippines trilateral to address China's 'gray zone' tactics," *Nikkei Asia*, April 1, 2024, https://asia.nikkei.com/Politics/International-relations/Indo-Pacific/First-U.S.-Japan-Philippines-trilateral-to-address-China-s-gray-zone-tactics; and Trevor Hunnicutt and Ernest Scheyder, "Exclusive: US, Indonesia to discuss potential for deal on EV minerals," Reuters, November 12, 2023, https://www.reuters.com/markets/commodities/us-indonesia-discuss-potential-deal-ev-minerals-sources-2023-11-12/.

43 Patsy Widakuswara, "Harris, Widodo Focus Talks on US Tax Credit for Indonesian Nickel," Voice of America, September 6, 2023, https://www.voanews.com/a/harris-widodo-focus-talks-on-us-tax-credit-for-indonesian-nickel-/7256259.html; and US Sen. Tina Smith et al. to Katherine Tai et al., "Concerns regarding a Potential Critical Minerals Trade Agreement," October 24, 2023, https://senatorkevincramer.app.box.com/s/raz2txgqb3omgujxlq1jdqs23ccycbl0.

that are key for green technology, so rebuffing strategic partners like Indonesia and the Philippines in their attempts to become "friendshoring" partners in this sector will only push them to integrate more closely with China. The best route for improving labor and environmental governance in this sector would be to negotiate enforceable high standards within a sectoral deal.

Pursue a sectoral approach to trade in other sectors

In addition to critical minerals, Washington and Tokyo should work together to negotiate sector-specific deals addressing discrete policy problems. Rather than the traditional broad-based market liberalization which has become anathema in Washington, a sectoral approach could "reset the agenda" on trade.[44] A sectoral approach could bring together select partners to negotiate a tailored agreement that includes a range of trade incentives and other policy tools to address a major challenge. For example, an agreement on green energy and technology could bring together the United States, Japan, the EU, South Korea, Indonesia, the Philippines, Malaysia, and Vietnam in an exchange of commitments that could include subsidies and tax credits for clean technologies, cooperation on green technology research, financing for green infrastructure, reliable access to critical inputs produced under high labor and environmental standards, and, perhaps, coordination on green government procurement policies.[45] Likewise, a sectoral arrangement on pharmaceuticals and medical devices could promote supply chain resilience and lessen dependence on China for these critical goods by coordinating industrial and trade policies. Digital trade and AI is another area where mutual gains could be made through rule-setting, policy coordination, and financial support for digital alternatives to Chinese entities.

Although trade agreements remain a tough sell in Washington, support for limited deals may be growing. A late 2023 report by the bipartisan US House of Representatives Select Committee on the CCP recommended a sectoral approach to trade agreements—in critical minerals, pharmaceuticals, digital rules, and other sectors—as a crucial policy tool for building collective economic resilience against China "in concert with allies."[46] This approach could be used to clearly advance US and Japanese strategic and economic goals, including promoting high labor and environmental standards, and put Washington back in the arena of meaningful economic engagement with its Indo-Pacific partners. Although the geopolitical argument for trade failed to save the TPP from bipartisan rejection, a sectoral approach may be a way to resuscitate trade policy.[47]

Build out the G7's agenda on economic coercion

The G7's agenda on economic security offers a useful framework for strengthening collective resilience and mitigating the threat of Chinese economic coercion. Given their own experience as targets, South Korea and Australia, as well as the EU and perhaps Taiwan, should be included in this work. This "G7 Plus" grouping should design new tools for a collective response to economic coercion incidents that may deter China from weaponizing economic interdependence to impose pressure.

Deterrence theory suggests two strategies for deterring an adversary: "deterrence by denial" and "deterrence by punishment." In the context of economic coercion, denial strategies make it unlikely that a potential aggressor will achieve its objectives. These strategies include, for example, reducing vulnerabilities by diversifying supply chains and boosting economic resilience by providing economic assistance to a targeted state, such as offering market access for boycotted goods or supplying critical inputs. Deterrence by punishment, on the other hand, imposes costs on China if it deploys economic coercion, such as through punitive tariffs or boycotts. In this vein, some have called for an economic collective self-defense agreement, similar to NATO's Article V, that would commit all member countries to retaliate with punitive economic measures if one member country is targeted,

44 Peter Harrell, "Time to Reset the U.S. Trade Agenda," Carnegie Endowment for International Peace, May 20, 2024, https://carnegieendowment.org/research/2024/05/time-to-reset-the-us-trade-agenda?lang=en.

45 Trevor Sutton and Mike Williams, "A New Horizon in U.S. Trade Policy," Center for American Progress, March 14, 2023, https://www.americanprogress.org/article/a-new-horizon-in-u-s-trade-policy/; and Charlie Martin, "Buy Clean on the Federal Stage – From Concept to Reality," BlueGreen Alliance, December 22, 2021, https://www.bluegreenalliance.org/resources/buy-clean-on-the-federal-stage-from-concept-to-reality/.

46 Select Committee on the CCP, "Select Committee Adopts Proposal to Reset Economic Relationship with The People's Republic of China," press release, December 12, 2023, https://democrats-selectcommitteeontheccp.house.gov/media/press-releases/select-committee-adopts-proposal-reset-economic-relationship-peoples-republic.

47 Peter E. Harrell, "How to Save Free Trade," *Foreign Affairs*, February 26, 2024, https://www.foreignaffairs.com/united-states/how-save-free-trade.

demonstrating a clear commitment to collectively impose costs for using economic coercion.[48]

Deterrence literature suggests that denial is often more effective than punishment, given that actions taken are upfront and clear.[49] It makes sense to start by focusing on denial, because some countries may not credibly be willing to bear the domestic political costs of escalating economic retaliation with China. Collective resilience should be enhanced by stepping up de-risking and supply chain diversification, especially in critical minerals and materials. The G7's Coordination Platform on Economic Coercion should be strengthened to include concrete public plans for coordinated actions to support countries targeted for economic coercion. These could include government arrangements for cost-sharing, along with identifying potential market alternatives for targeted goods and corresponding private sector incentives.

Engaging less-developed Indo-Pacific countries is also critical for effective deterrence of Chinese coercion, since it is these more vulnerable economies that are often victims of China's punitive economic tactics. A "G7 Plus" framework could be extended to key partners in Southeast Asia, India, and Fiji by building an economic coercion agenda with similar principles and a framework for response within the IPEF supply chain pillar.

Align "G7 Plus" on export controls to replace the Wassenaar Arrangement

Export controls have been central to US efforts to counter China's acquisition of advanced semiconductor technology, but success hinges on coordinating technology restrictions with other advanced economies. The parallel actions taken by Japan and the Netherlands to strengthen restrictions on exports of advanced semiconductor equipment, materials, and chips were an important step. But other advanced economies have allowed Chinese firms to acquire advanced chips and chip-making technology.[50] Worse, Washington's piecemeal approach so far risks harming US firms facing government export restrictions without stopping the leakage of technology.[51]

The United States and Japan should forge a new multilateral arrangement with key allies to control exports of advanced semiconductors and other critical technology. The existing multilateral regime for controlling dual-use technology exports, the Wassenaar Arrangement, is not workable for controlling advanced technology exports to China. Wassenaar is a consensus-based framework that suffers from many weaknesses, foremost that Russia is a member. A new arrangement of like-minded countries with advanced technology sectors is needed. The G7 is the logical starting point—with four G7 members being major players in semiconductors (the United States, Japan, the Netherlands, and Germany)—plus Australia, South Korea, and Taiwan. To be effective, a G7-Plus arrangement must respond to rapidly changing technologies through cooperation on export policies, robust information and intelligence sharing, and closely coordinating review processes.[52]

48 Dmitri Alperovitch, "Democracy Needs an Economic NATO," *Foreign Policy*, May 23, 2024, https://foreignpolicy.com/2024/05/23/democracy-economic-nato-china-coercion-taiwan/.

49 Paul Huth and Bruce Russett, "Deterrence Failure and Crisis Escalation," *International Studies Quarterly* 32, no. 1 (March 1988): 29–45, https://doi.org/10.2307/2600411; and Michael J. Mazarr, *Understanding Deterrence*, *RAND Corporation*, 2018, https://www.rand.org/content/dam/rand/pubs/perspectives/PE200/PE295/RAND_PE295.pdf.

50 Cheng Ting-Fang, "How China's tech ambitions slip through the U.S. export control net," *Nikkei Asia*, October 20, 2023, https://asia.nikkei.com/Business/Business-Spotlight/How-China-s-tech-ambitions-slip-through-the-U.S.-export-control-net#.

51 *Economist*, "Are America's allies the holes in its export-control fence?" October 16, 2023, https://www.economist.com/business/2023/10/16/are-americas-allies-the-holes-in-its-export-control-fence.

52 Ayaka Hiraki, "Japan's export controls require reassessment," East Asia Forum, April 10, 2024, https://eastasiaforum.org/2024/04/10/japans-export-controls-require-reassessment/.

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