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Economic Security and The Revival of Industrial Policy in Japan[1]

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Abstract

This paper examines the revival of industrial policy in Japan and its transformation under the pressures of economic security. It argues that the current shift in Japan's policy draws on elements of its postwar developmental state experience, including state coordination, sectoral targeting and public support for strategic industries, but operates in a fundamentally different economic and geopolitical environment. Whereas earlier industrial policies were aimed at catch-up growth and export competitiveness, today's agenda is shaped by supply chain vulnerability, US–China strategic rivalry, technological competition, energy insecurity and the weakening of multilateral trade disciplines. The paper traces the shift through Japan's historical industrial policy experience, the reshaping of economic security as a policy rationale, and the introduction of contemporary policy instruments such as the Economic Security Promotion Act (2022), semiconductor subsidies, critical minerals policy and green transformation initiatives. It argues that Japan's new industrial policy seeks both strategic autonomy and strategic indispensability, but also creates trade-offs between resilience, efficiency, fiscal sustainability and openness. The paper concludes that Japan offers both a model and a cautionary case: its policies demonstrate how advanced economies are adapting to global disorder, while highlighting the need for stronger international subsidy disciplines to manage cross-border spillovers and fiscal risks, which would be aided by a renewed commitment to the rules-based multilateral trading system.

Keywords: industrial policy, economic security, Japan.
JEL classification: F13, L52

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I. Introduction

Industrial policy has returned to the centre of economic policymaking with a force that would have seemed improbable even a decade ago. By the late 20th century, industrial policy had fallen out of favour with industrial economies and was largely associated with developing and late-industrialising economies, particularly those in East Asia (Khan 2015). But this norm has since been upended. Starting in the aftermath of the Global Financial Crisis (GFC) of 2008–10, but especially since the disruptions to supply chains during the COVID-19 pandemic, governments across the advanced industrial world—including Europe and North America—returned to the time-honoured tradition of state-led industrial policy. Government support, corporate bailouts and capital injections into the financial sector were *de rigueur* in the post-GFC period, with targeted subsidies now commonplace. An economic toolkit once dismissed as outdated and distortionary has again become a standard feature of economic policymaking (Aiginger and Rodrik 2020).

The 2010s and early 2020s saw a noticeable expansion in both the scope and rationale of industrial policy. This was partly driven by the geopolitical and geoeconomic tensions between the United States and China, which heightened concerns about the fragmentation of supply chains and intensified competition in advanced technology sectors (Hauge, Houtzager and Hörmann 2025). The growing urgency of decarbonisation efforts as a response to climate change has also pushed governments to intervene more directly in their economies to accelerate the green transition (GX, in Japan) and address emerging challenges. The COVID-19 pandemic reinforced this pattern, before the war in Ukraine cemented the view that interventions were necessary to secure supply chains. Emergencies with supply chain disruptions are increasing in frequency in a highly interconnected global economy. From securing and producing essential goods to providing economic support for industries affected by lockdowns and later seen as vulnerable to disrupted supply, the crisis underscored the importance of government intervention (Goto 2022). Together, these developments highlight the new role of industrial policy as a means of navigating the economic consequences of an increasingly contested and uncertain global environment.

Japan lies at the fault line of these changes. Its postwar prosperity has been built on deep integration with the global economy, supported by the multilateral rules-based economic order and close ties to the United States and China (Armstrong and Urata 2023). Japan has faced particularly acute pressure

from the escalating US–China trade war, given its position between the two powers, and the fact that it relies on imports for roughly 85 per cent of its energy and strategic raw materials, making its economic statecraft an important subject of analysis (Armstrong, Solís and Urata 2025). In response to mounting supply chain disruptions, energy insecurity linked to conflicts in Europe and the Middle East, and technology decoupling between Washington and Beijing, alongside a wider climate of global uncertainty, Japan has moved quickly to institutionalise a raft of economic security policies (Koyu et al. 2022). These measures have been designed to insulate the economy from future disruptions and are framed explicitly in terms of resilience and economic security. In this respect, Japan has emerged as an apparent global leader, developing one of the most advanced and systematic policy responses to operationalise economic security in response to a changing global order (Tiberghien 2024).

Japan's return to industrial policy is not without precedent. Since the end of World War II, industrial policy has been used to support the country's postwar economic reconstruction and pursuit of a high-growth economy. What distinguishes the current phase, however, is both the programme's scale and the extent to which it is shaped by concerns of economic security. Japan's 'mission oriented' industrial policy framework covers 8 sectors that include the green transition (GX), digital transformation (DX), other domestic structural priorities and economic security (METI, 2025). The increasing fusion of Japan's economic and national security policies has given rise to a set of policy frameworks that appear to prioritise national security over economic prosperity (Armstrong and Urata 2023). This raises a series of questions that extend beyond Japan itself. What distinguishes economic security policy from traditional industrial policy? Can industrial policy be used to manage economic and strategic vulnerabilities without undermining the benefits associated with global integration? And how should the apparent trade-offs between security and prosperity be evaluated in an economy whose success has long depended on deep integration with global markets?

Addressing these questions first requires clarifying what is meant by *industrial policy*. While the concept has no universally agreed-upon definition, it may be usefully understood as "government policy aimed at achieving structural transformation of economic activities in pursuit of public objectives" (Juhász, Lane and Rodrik 2023). By this account, industrial policy is not limited to traditional sectoral targets. Its objectives include promoting innovation, enhancing productivity and fostering economic growth, while its scope and rationale are similarly diverse. Policies may be

directed at particular industries, regions, or firms, and are implemented through a wide range of instruments, including fiscal support, technological programmes and trade-related measures (Aiginger and Rodrik 2020). This broad definition provides a comprehensive framework for analysing how industrial policy has evolved in the Japanese context.

The focus of this paper is on Japan's industrial policy deployed in the name of economic security. Economic security in Japan aims to achieve strategic autonomy and strategic indispensability, and is thus broad in scope, with industrial policy being one means of achieving those aims. The paper is organised as follows. Section II analyses the historical context behind Japan's recent industrial policy revival, drawing out several key lessons that can inform current policy debates. Section III situates this revival within the emerging economic security environment, examining the role of external pressures such geopolitical competition, supply chain disruptions and the COVID-19 pandemic. Section IV then outlines Japan's contemporary policy framework, before Section V analyses how it differs from past Japanese industrial policy and evaluates the economic trade-offs involved. Section VI concludes by considering the international context of Japan's policies and identifying avenues for future research.

II. Historical Background: Japan's Industrial Policy Experience

The origins of Japan's postwar industrial policy lie in the reconstruction period of the late 1940s and early 1950s. In the immediate aftermath of World War II, Japan was left economically and physically devastated, facing severe shortages of raw materials and a widening technological gap with Western industrialised nations (Okuno-Fujiwara 1991). Industrial production had also collapsed: by 1945, it had fallen to about 30 per cent of its prewar level, measured against the 1934–36 average (MOF 1978). Basic industries such as steel and coal were in a state of collapse, imports had been cut off, and the country struggled to secure sufficient energy and food supplies. Amid these conditions, the General Headquarters of the Allied Forces introduced a series of structural reforms aimed at reorganising the Japanese economy. The measures included: the dissolution of the *zaibatsu*, vertically-integrated business conglomerates that had dominated the Japanese economy since the Meiji era (1862–1912), to eliminate the concentration of economic power; land reform to promote

independent farming; and labour reform to legalise trade unions (Kosai 1984; Urata 2026). Macroeconomic stabilisation was also an immediate priority. To address inflation caused by severe shortages of goods, fiscal balance and tight monetary policies were implemented. Balance-of-payments deficits were managed through import controls under a foreign exchange allocation system—the establishment of the Ministry of International Trade and Industry (MITI) in 1949 to administer this system was a key institutional development (Johnson 1982).

These early policies were shaped by contextual necessity: underdeveloped capital markets limited firms' ability to finance large investments, while the economic destruction wrought by the war left the economy unable to coordinate large-scale industrial recovery. This context changed following the outbreak of the Korean War in 1950, which provided an external stimulus that accelerated Japan's economic recovery (Dingman 1993). US military procurement from Japan triggered rapid recovery in sectors such as textiles, steel, machinery and transportation. As foreign reserves accumulated, Japan gained access to imported capital goods that had previously been in short supply. This industrial expansion—marking the shift from immediate postwar reconstruction to the establishment of a foundation for long-term growth—coincided with the fixing of the exchange rate to the US dollar in 1949 (Kosai 1984). This measure exposed Japanese firms to international competition under a stable exchange-rate regime, causing key industries to invest heavily in equipment modernisation to rationalise production. The government supported this transition through tax incentives, fiscal investment and loan programmes. Since rationalisation required importing machinery and introducing foreign technologies, foreign exchange control and the regulation of foreign capital became important policy instruments (Kosai 1984; Okuno-Fujiwara 1991). These early rationalisation policies marked the emergence of Japan's targeted approach to industrial policy, in which the state played an active role in supporting sectors deemed critical to economic development.

Japan's industrial rationalisation is generally considered successful, although its results were uneven. The steel industry became internationally competitive and later developed into an export industry, while the coal industry failed to rationalise effectively (Kosai 1984). Even in sectors that did succeed, however, the precise contribution of government policy is difficult to isolate. Many firms had already regained profitability thanks to the Korean War boom, and had strong incentives to rationalise regardless of state support (Kosai 1984). The case for intervention rested not only on the

idea that firms would fail to act alone, but on the scale and risk of the investment required: rationalisation required new technologies and equipment that were too costly and uncertain for individual firms to undertake alone. In this context, industrial policy offered a means of overcoming the financing constraints and coordination failures present in the overwhelmingly pre-industrial economy.

The high-growth period from the late 1950s to early 1970s is most closely associated with the developmental state model. During this period, industrial policy became more systematic and ambitious, with the aim of Japan becoming an internationally competitive export economy (Tsuruta 1984). To achieve rapid economic growth, the government adopted various policy instruments, including import protections, low-interest loans, subsidies and tax incentives. These measures were directed towards key sectors—such as steel, shipbuilding, petrochemicals and automobiles—contributing to the rapid development of Japan's heavy and chemical industrial base (Tsuruta 1984). These industries were targeted for their products' high income elasticity of demand and productivity growth rates, offering significant future returns on investment as global incomes rose and the Japanese economy became more efficient. By protecting infant industries from foreign competition, the idea was that firms could secure learning-by-doing benefits and achieve economies of scale, eventually becoming globally competitive. MITI played a central role in this process through its formal authority over foreign exchange allocation and industrial policy, as well as its capacity to coordinate across government and industry (Johnson 1982; Flath 2014). Major policy decisions were driven by direct consultation with industry through the *shingikai* (deliberation councils) composed of business leaders, former bureaucrats and experts (Komiya 1984). This institutional framework allowed the state to closely align industrial policy with firm-level incentives.

Many theoretical or descriptive accounts of this period praise the effectiveness of Japan's early industrial policies. For example, Johnson commends the country's "miraculous" economic development, which he attributes to MITI's strategic use of foreign exchange allocations, provision of public financing, management and localisation of technology imports, and administrative guidance (Johnson 1982). After all, the share of heavy and chemical industries in total manufacturing rose sharply from 44.6 per cent in 1955 to 62.3 per cent in 1970, while the machinery industry grew from 15.0 per cent to 32.3 per cent over the same period (Ahn 1986). However, several closer examinations of sectoral productivity dispute the effectiveness of targeted support (Ohashi 2005;

Ambashi 2022). Beason and Weinstein (1996) found that Japanese industrial policy from 1955 to 1990 was heavily targeted towards inefficient sectors which experienced limited productivity growth, while finding no evidence that industrial policy contributed to productivity in successful industries. These and other findings cast doubt on the extent to which targeted intervention—rather than broader economic conditions—drove Japan's postwar industrial success (Ohashi 2005).

The oil crises of 1973 and 1979 altered both the objectives and instruments of Japan's industrial policy. Rising energy costs prompted a shift towards less resource-intensive industries, with the focus of policy moving from heavy industries to knowledge-intensive and high value-added industries such as semiconductors and information technology (Uekusa 1984). This came amid a shifting global attitude towards state intervention. From the 1970s to the 2000s, the prevailing sentiment was that reducing government intervention in economic activities and increasing reliance on market mechanisms would enhance economic efficiency and promote growth (Harvey 2005). This was an approach championed by UK Prime Minister Margaret Thatcher and US President Ronald Reagan, and subsequently spread to other countries, including Japan. In the 1970s, as Japan's trade surplus caused diplomatic tensions with the United States, the government pursued structural reforms centred on deregulation and liberalisation (Uekusa 1984). While these reforms were partly due to pressure from the US government, they received widespread domestic support due to the belief that excessive regulation and protectionist measures were weakening Japan's economic vitality and hindering growth.

It was during this period that the formal concept of "economic security" (*keizai teki anzen hosho*) emerged in Japanese policymaking. Drawing on concerns about the country's resource dependence revealed during the 1970s oil crises, Masataka Kosaka developed the term as part of the broader framework of "comprehensive security" (*sogo anzen hosho*) adopted by the Ohira government in 1980 (Armstrong and Urata 2023). Kosaka's account, developed further by other scholars, expanded the idea of national security beyond military concerns to include economic, energy and food security (Vargas-Rodriguez 2025). At this seminal point for Japanese policy, economic security encompassed three objectives: sustaining the free trade system while addressing imbalances between the Global North and South; improving diplomatic relations with key trading partners; and preserving energy and food security (Armstrong and Urata, 2023). For a resource-scarce economy like Japan, these concerns were particularly acute, prompting efforts to diversify energy sources away from Middle

Eastern oil and strengthen the international trade system. This highlights a core continuity in Japan's approach to international trade: the state's objective is to manage interdependence, not retreat from it.

The 1990s and early 2000s saw a significant shift away from the developmental state model, with the Japanese government taking a less active role in economic management. The collapse of the Japanese asset bubble at the beginning of the 1990s precipitated a period of prolonged economic stagnation—the so-called "Lost Decade"—which continued into the years following the GFC (Yoshikawa 2007). In line with global trends, the government adopted industrial reforms that encouraged industrial reorganisation driven by market mechanisms. Industrial policy was scaled back and greater emphasis was placed on private-sector-led restructuring (Beeson 2009). The industrial policies that remained were sector-specific and highly targeted. The government supported the rapidly advancing information-technology revolution by implementing industrial policies to strengthen the information and communications technology sector. By the late 2000s, the government had begun responding to population ageing and declining birth rates by directing support to the medical and nursing care sectors (Nozaki, Kashiwase and Saito 2017). To address environmental and energy challenges, innovation-oriented policies were also strengthened.

Government policies of the 2000s were not so interventionist compared to the MITI-led policies of the high growth era, or compared to what would be gradually deployed from the late 2010s in response to rising economic security risks (Morita-Jaeger 2025). Japanese policy largely followed the Washington Consensus until that started to break down in the mid-2010s after the GFC, the election of President Doland Trump in 2016 and Brexit, which all started to cast doubt on the norms and assumptions underlying the mix of state and market in many advanced industrialised economies.

III. The New Economic Security Environment

The revival of industrial policy in Japan has occurred in response to a series of overlapping and correlated challenges that have fundamentally altered the global economic environment. For Japan, these developments—geopolitical rivalry, the weakening of multilateral economic governance and

systemic shocks—have been particularly consequential. Its growth model has long depended on open markets and a rules-based multilateral trading system, along with assured protection from the US security umbrella (Iida 2018). Central to Japan's economic security is energy security for which it relies on the open international market. As those conditions have weakened, the need to manage economic vulnerability has moved to the centre of policymaking.

Five related trends underpin this shift (Armstrong and Urata 2023). First, the rapid rise of China as an economic, political and military power has rearranged the global trading order. This is reflected in the increasing significance of its bilateral trading relationship with Japan. In 2000, the United States accounted for 24.7 per cent of Japan's total trade, while China's share was only 10.9 per cent. By 2023, this dynamic had reversed, with China accounting for one-fifth of Japanese trade—down from a peak of 23.9 per cent in 2020—while the United States made up just 15 per cent (Armstrong 2024). Japanese firms also rely heavily on Chinese production in some sectors, including electronics and medical goods. For example, China supplies 99 per cent of Japan's laptops and tablets, and 66 per cent of its medical goggles (Armstrong and Urata 2023). This deepening economic relationship has been a stabilising force in bilateral relations, creating strong incentives to manage the tides of political tension. However, heavy reliance on Chinese manufacturing capacity means that disruptions can be transmitted quickly through the Japanese economy. This vulnerability was illustrated in 2010, when an informal Chinese embargo on rare earth exports following a maritime dispute disrupted supplies of critical inputs to Japanese industry (Gholz and Hughes 2021). Such episodes have reinforced the extent to which economic dependence on China exposes Japan to strategic risks.

Second, the United States' retreat from its traditional role as the central pillar of the multilateral trading system has weakened the institutional foundations of the global economic order on which Japan has relied (Armstrong and Urata 2023). The rise of the "America First" agenda has marked a shift away from rules-based economic governance towards a more power-based, transactional approach to trade. Early policy decisions, such as the United States' withdrawal from the Trans-Pacific Partnership in 2017, created significant uncertainty for both Japan and the broader Asia Pacific, removing a key mechanism for institutionalising trade liberalisation and anchoring US economic engagement in the region (Armstrong and Urata 2023). More broadly, US trade policy during this period—characterised by tariffs, bilateral pressure and threats against competitors and allies alike—introduced a degree of unpredictability previously absent from the global economy.

This dynamic has intensified in Trump's second term, with economic tools now more openly deployed to leverage the country's dominant trading position for political concessions. His Liberation Day so-called reciprocal tariffs levied on imports from all sources, and specific targeted threats against Canada, China and Mexico, reflect such a political logic, while his stance on Gaza, Greenland and Ukraine point to a more explicit use of economic leverage to secure strategic concessions (Armstrong 2025). The United States' increasingly protectionist stance across both the Trump and Biden administrations has also contributed to the paralysis of the World Trade Organization (WTO). These shifts risk turning the international economic order into a system governed by the principle of "might is right," where outcomes depend increasingly on the preferences of the great powers. One notable feature of the Trump 2.0 trade policy has been the inclusion of commitments to invest in the United States as part of trade negotiations. In the case of Japan, the Japanese government pledged to facilitate up to $550 billion in investment in the United States in the US-Japan agreement announced in July 2025[2]. This commitment was widely viewed as part of a broader arrangement under which Japan avoided additional liberalization of agricultural imports and secured lower U.S. tariffs on automobile exports than had initially been threatened.

Third, the intensification of strategic competition between the United States and China has further constrained Japan's economic policy choices. The trade war between the world's two largest economies—and Japan's two largest trading partners—escalated in 2018 and 2019, resulting in a series of mutual retaliatory measures and countermeasures that have disrupted global trade flows (Ju et al. 2024). Although the two countries' Phase One trade deal, reached in January 2020, brought a temporary pause to the hostilities, it shifted the bilateral relationship towards a form of managed trade that sits outside established WTO rules and norms. This departure from multilateral principles had significant implications for third countries, as trade flows were diverted and market access became increasingly contingent on political bargaining. For Japan, this translated into direct pressure to adjust its own trade policy, culminating in the US–Japan Trade Agreement, which was concluded in 2019. Despite a preference for multilateral frameworks, Japan committed to increasing imports of US agricultural products under the threat of high tariffs on automobile exports (Armstrong and

[2] Tokyo committed to the fund to rebuild core American industries, energy dominance, and critical infrastructure. It is reported that only $5.5 billion to $11 billion (1% to 2%) will be actual capital, with the rest comprised of loans and bonds backed by the Japan Bank for International Cooperation (JBIC). The agreement was for all investments and projects to be finalized before the end of the US presidential term in 2029. Projects are recommended by a US investment committee chaired by the Commerce Secretary and finalized by the President. Investment commitments were also included in agreements with South Korea, Taiwan and others.

Urata 2023). Similar dynamics played out globally, as countries such as Canada, South Korea and Mexico negotiated ad hoc arrangements to avoid US tariffs. These arrangements, which included voluntary export restraints, pledges to increase market access for US exports and provisions designed to limit partners' economic engagement with China, have operated outside established multilateral rules (Pauwelyn 2025). These developments point to the emergence of an increasingly anarchic system of global trade, where trading outcomes are shaped by the whims of the great powers.

Fourth, the emergence of new digital and cyber technologies has reshaped how economies interact. Developments in fields such as artificial intelligence, semiconductors, quantum computing and biotechnology are increasingly recognised as dual-use technologies with implications for both economic competitiveness and national security (Drezner 2024). This is reflected in the growing use of technology controls as instruments of strategic policy, with control over critical technologies now serving as a primary arena for US–China great-power competition (Ju et al. 2024). For example, the United States has sought to slow China's technological development through targeted export controls, including by prohibiting US firms from supplying advanced equipment that would enable China to develop domestic semiconductor production capabilities (Armstrong, Solís and Urata 2025). The United States has utilised international negotiations to encourage key partners within semiconductor and advanced technology supply chains to align their export controls. Following talks with the United States and the Netherlands, Japan expanded its own list of controlled items in March 2023, adding 23 categories of semiconductor equipment (Morita-Jaeger 2025). However, Tokyo stopped short of explicitly targeting China, maintaining a country-neutral approach in line with non-discrimination rules.

Fifth, the COVID-19 pandemic exposed the fragility of global supply chains, underscoring the risks associated with highly integrated production networks. Japan's industrial expansion has been supported by complex supply chains that enable firms to achieve fragmented, tasked-based specialisation through just-in-time production (Matsui 2007). This has made the Japanese economy more exposed to upstream disruptions to supply chains. As Chinese factories and suppliers entered lockdown in 2020 to contain the COVID-19 virus, the supply of key inputs was halted. The tightly integrated nature of the supply chains which Japan relied on meant the economic effects were quickly transmitted through the economy, as the experience of the automobile industry clearly

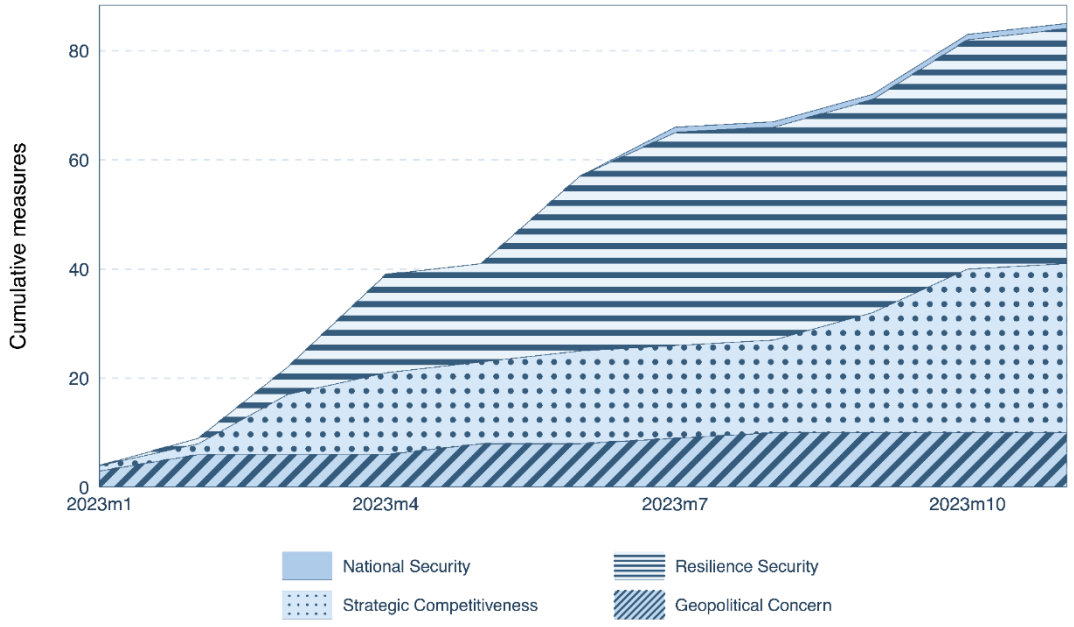
illustrates (Armstrong and Urata 2023). Factory closures in Wuhan in late January 2020 halted the production of automobile parts, forcing Japanese automobile assemblers to suspend operations across China and Japan, among other countries. Vehicle production in Japan fell by 10 per cent in February compared to the previous year, before declining further as the virus spread within Japan. The declaration of a state of emergency in April led to widespread factory shutdowns, with production dropping by around 45 per cent relative to the previous year (Armstrong and Urata, 2023). Although production resumed as domestic restrictions were lifted, demand for automobiles was down amid ongoing uncertainty and pessimism within the global economy. This episode demonstrated how supply chains can amplify local disruptions into a nationwide economic shock.

The changing economic security environment has been accompanied by a clear global shift in policy, reflected in the growing use of distortive trade measures. Data from Global Trade Alert (2026) shows a marked increase in "harmful" trade interventions—policies that raise barriers to trade by discriminating against foreign commercial interests—over the past decade. Among G20 countries, the number of such measures remained relatively stable in the years following the GFC, rising only slightly from 2520 in 2009 to 2600 in 2015. Since then, however, the use of restrictive trade measures has sharply risen, reaching 4786 measures in 2022—an increase of 84.1 per cent relative to 2015. A similar pattern is observed globally: across all countries, the total number of harmful interventions rose from 3197 in 2015 to 5956 in 2022, an increase of 86.3 per cent (Global Trade Alert 2026). Industrial policies comprise a significant portion of these interventions. Based on calculations from Global Trade Alert (2026) and Evenett et al. (2024), industrial policy accounted for a substantial share of harmful trade interventions in 2023: 61.2 per cent in Japan, 48.3 per cent in the United States and 47.5 per cent across G7 countries. These trends suggest that governments are increasingly willing to intervene in trade in ways that prioritise domestic concerns over multilateral commitments, indicating a broader fragmentation of the global economic order. They point to a broader reorientation of international economic policy as a reaction to a changing economic security environment.

Japan's strategic calculus is informed by the constraints of its position between the United States and China, as well as its continued reliance on global markets. Policymakers have shifted their focus towards sustaining the resilience of Japan's advanced economy under conditions of uncertainty, emphasising the importance of strengthening supply chain resilience, particularly for critical goods

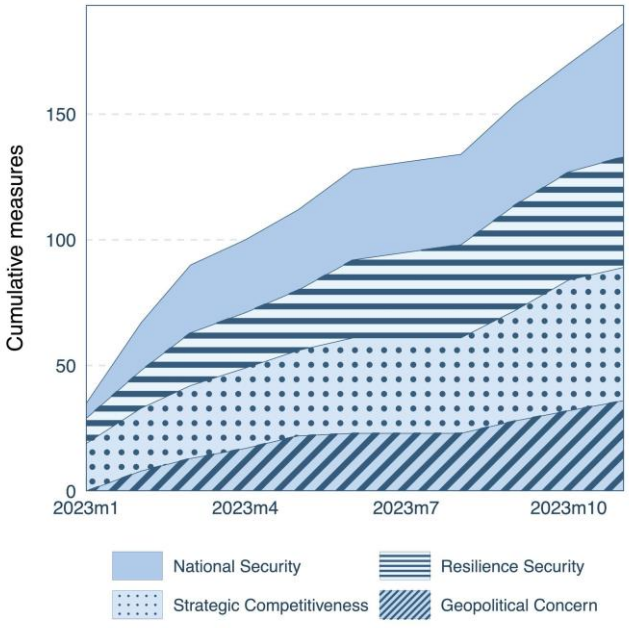
such as semiconductors, pharmaceuticals and critical minerals. Given the limits of domestic capacity, this has been pursued through a combination of selective onshoring, supply chain diversification and stockpiling of processed rare earths, for example, alongside efforts to build supply chain partnerships with countries such as the United States, Australia and members of the European Union. This is evident in Figure 1, which demonstrates that the vast majority of Japan's harmful trade interventions are motivated by resilience security and strategic competitiveness, as opposed to national security and geopolitical concerns, as classified by the Global Trade Alert (Evenett, et al. 2024). This pattern contrasts sharply with other advanced economies, including the United States (Figure 2) and the members of the G7 (Figure 3), where harmful trade interventions are more evenly distributed across the four categories. While other post-industrial countries deploy protectionist measures primarily in support of their national security interests, Japan stands out for using them more extensively to advance its domestic economic goals.

Figure 1: Japan's trade industrial policies with stated motivation



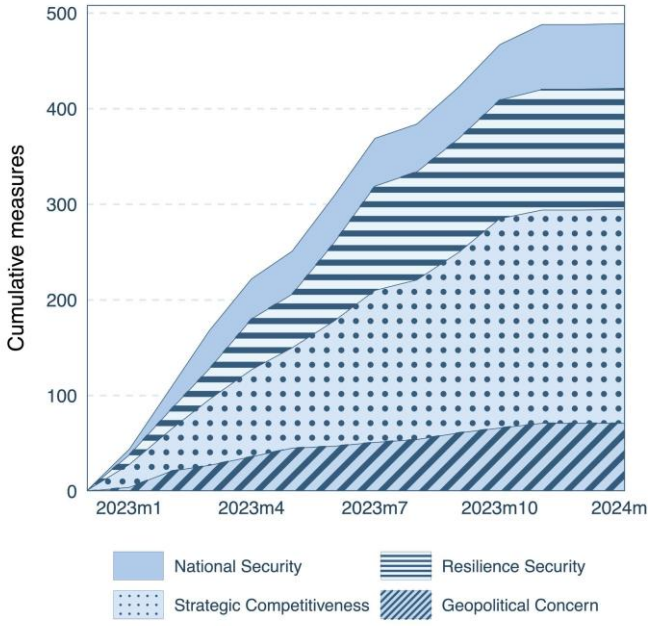
Source: Authors' calculation from data in Evenett et al. (2024)

Figure 2: United States' trade industrial policies with stated motivation



Source: Authors' calculation from data in Evenett et al. (2024)

Figure 3: G7 countries' trade industrial policies with stated motivation



Source: Authors' calculation from data in Evenett et al. (2024)

This logic has extended to Japanese industrial policy more broadly, with recent frameworks developed by METI integrating economic security with long-term goals of innovation and investment (METI 2025). But Japan has not abandoned the rules-based economic order, which has eroded over the past two decades. Tokyo earlier spearheaded efforts to sustain multilateral trading frameworks, such as leading the conclusion of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and being party to the Regional Comprehensive Economic Partnership (RCEP), two of the world's largest regional trade agreements (Armstrong and Urata 2023). Japan has also expanded cooperation with "like-minded" partners in areas such as technology standard-setting and joint investment, indicating an attempt to manage rising geopolitical risk while preserving the open economic structures that underpin Japan's long-term prosperity. How Japan manages its large and important economic and political relationship with China under these circumstances, becomes an important question.

IV. Japan's Industrial Policy Revival: Frameworks and Instruments

Japan's industrial policy revival sits within this broader shift towards economic security. This shift is not merely about defending Japan against external threats, but about ensuring the sustainability of economic activity itself by maintaining national economic autonomy, technological superiority, and the stable supply of critical goods and technologies. Thus, Japan's new industrial policy—aimed at strengthening economic security—represents a qualitative change from the traditional focus on economic efficiency towards greater emphasis on resilience, framed around the goals of strategic autonomy and strategic indispensability.

The centrepiece of this shift is the Economic Security Promotion Act (2022), which seeks to actively promote "economic measures for national security" (Koyu et al. 2022). The legislation is built around four pillars: securing the supply of critical goods, protecting key infrastructure, supporting the development of enhanced technologies and restricting the disclosure of sensitive intellectual property (Armstrong 2024). Under the first pillar, Japan introduced legal provisions within Japan's National Security Strategy to reduce excessive dependence on certain countries with strategically significant goods (Suzuki 2023). It also identified 11 critical commodities, including semiconductors, batteries and aircraft components, and established loan-based financial support to assist private companies in increasing their domestic production (Suzuki 2023). The second pillar introduced new pre-screening and notification requirements for the installation of infrastructure or outsourcing of maintenance or management in sectors such as electricity, transportation, telecommunications, banking, insurance and finance (Armstrong 2024). Under the third pillar, Japan has adopted a new industrial policy targeting 20 critical technologies to advance its goal of becoming a globally indispensable economic partner. Finally, the fourth pillar restricted disclosure of patents in 25 sensitive fields with military and security applications. This was complemented by a "security clearance" system implemented by the government in 2024, which enables the government to classify information on economic security grounds.

The scope of Japanese economic security policy has since expanded under Prime Minister Sanae Takaichi, who announced her government's plan to channel investment into 17 so-called "strategic

fields" in November 2025 (Ishikawa 2025). These fields include artificial intelligence, drug discovery, quantum technology and shipbuilding, ranging from heavy industry to advanced technology. Under the plan, the government has identified 61 different products for support, with a strong emphasis on public–private partnerships (Yokoyama and Terukina 2026). Takaichi's administration has revived Abe-era government spending patterns, marked by large-scale fiscal intervention and a willingness to deploy public resources to shape industrial outcomes. The FY2026 budget significantly increases state support across strategic sectors, committing over 10 trillion yen (US$62.8 billion) in public support to the semiconductor industry by FY2030 and 8.8 trillion yen (US$55.2 billion) for defence (MOF 2026). The budget also earmarks 20 trillion (US$125.5 billion) in upfront funding for GX initiatives, with the aim of mobilising more than 150 trillion yen (US$941.2 billion) in public–private investment over the next decade (MOF 2026). These measures highlight the expanding scale and scope of Japan's economic security agenda, with state support extending across a broad set of strategic sectors.

Japan's policy focus is most heavily concentrated in the semiconductor industry, illustrating its importance as both a critical economic input and a realm of geopolitical competition. Under the Economic Security Promotion Act (2022), the sector received the largest share of subsidies: over the three years to April 2024, the Japanese government allocated 3.9 trillion yen in subsidies to the industry. This is equivalent to roughly 0.71 per cent of GDP and is among the largest government subsidy programmes for the semiconductor industry worldwide, behind only the United States and likely China in absolute terms, but higher than the United States relative to GDP (Negrine 2024). More than half of this support has gone to bringing the Taiwan Semiconductor Manufacturing Company (TSMC) to Kumamoto, at 1.2 trillion yen, and establishing the state-backed semiconductor manufacturer Rapidus, at 920 billion yen (Armstrong 2024; Urata 2026). The initiatives form the two pillars of Japan's semiconductor drive; while TSMC's operations in Kumamoto, called Japan Advanced Semiconductor Manufacturing (JASM), focus on producing legacy chips, Rapidus aims to develop domestic capacity for next-generation semiconductors currently only manufactured in Taiwan. As part of Japan's broader approach to subsidies, the projects' funding is tied to conditions and performance targets to ensure public investment delivers domestic capacity, technology transfer and job creation rather than simply underwriting private profits (Negrine, Findlay and Armstrong 2025). This structure combines immediate security supply

with a longer-term bid to regain Japan's previous mantle as a technological leader in the semiconductor industry[3].

The second prong of this effort, Rapidus, represents a more ambitious attempt to rebuild Japan's position at the technological frontier. Established in 2022 by eight major Japanese firms—Toyota, Sony, NTT, NEC, Denso, Kioxia, SoftBank and MUFG Bank—the company plans to begin production of cutting-edge 2-nanometre logic semiconductors by 2027 through its partnership with IBM (Akabane 2026). It aims to rebuild domestically the advanced manufacturing capabilities that Japan lost after its decline in the 2000s, when production shifted overseas and restructuring weakened its once world-leading semiconductor industry (Negrine, Findlay and Armstrong 2025). Given the growing geopolitical and supply chain risks, securing a domestic base for advanced semiconductor production has become a top national security priority. Cutting edge semiconductor production only occurs in Taiwan, creating a significant vulnerability with a negative security externality. If Rapidus succeeds in achieving mass production of 2-nanometre chips, it could transform Japan's semiconductor landscape: reviving domestic manufacturing, stimulating upstream and downstream sectors related to semiconductor equipment, materials and design, and strengthening competitiveness in artificial intelligence, automobile and quantum industries (Akabane 2026). Alongside significant financial investment, the Japanese government has supported the company by establishing a broader consortium linking industry, academia and research institutions to accelerate the effort. It is a high-risk bet by the government, but there is some evidence, albeit from experience in developing economies, that subsidising upstream sectors can minimise policy mistakes (Liu 2019). The success of Rapidus, which faces significant headwinds due to its substantial technological and scale gap with TSMC and other leading competitors, will serve as a litmus test of whether Japan's industrial policy can deliver lasting competitiveness.

Japan's contemporary industrial policy also explicitly incorporates a defence dimension, reflecting the growing overlap between economic security and national security. Many of the sectors treated as strategically important, including semiconductors, have dual civilian and military technologies, blurring the distinction between industrial policy and defence policy. This joint approach is

[3] Given the economies of scale involved in the semiconductor industry, it could be argued that Japanese government support to the industry is akin to infant industry industrial policy, but the justification for direct subsidies has been framed around economic security and as an important upstream industry for Japanese manufacturing. The imports of semiconductors have not been restricted.

embedded in the Economic Security Promotion Act (2022), which supports the development of sensitive technologies and restricts patent disclosure in fields with military applications (Armstrong 2024). The Japanese government's investment in the defence industry has accelerated under Takaichi, with her cabinet approving a record-high defence budget in December 2025 as part of a plan to raise defence spending to 2 per cent of GDP by FY2027 (Davidson 2025). This has included increased drone and missile procurement, and comes amid a broader re-evaluation of the country's defence strategy.

Japan has also directed significant policy attention towards GX efforts, driven by concerns over energy security and decarbonisation. It is one of eight mission-oriented priority areas identified by METI, placing it alongside concerns like demographic change, digitalisation and health as a central focus of industrial policy (METI 2025; Urata 2026). In this context, decarbonisation is closely linked to two challenges, the first of which is diversifying Japan's energy supply and demand (Ohta and Barrett 2023; Vivoda 2026). This objective has been pursued by reducing the country's heavy dependence on Middle Eastern oil, alongside a suite of policy measures aimed at expanding domestic renewable capacity. The measures include subsidies, feed-in tariffs and a 2 trillion yen Green Innovation Fund to promote investments in renewable energy and low-carbon infrastructure (Ozawa, Tsani and Kudoh 2022). They are complemented by support for research and development in areas such as energy storage, green hydrogen and electric vehicles, designed to reduce reliance on imported fossil fuels while decreasing overall energy demand (Vivoda 2026).

A focus of economic security policy has also been on the security of supply of critical minerals, including rare earths. The processing of critical minerals and rare earths is dominated by China and Japan is the largest customer outside of China. There has been some success in insuring against supply stoppages, such as the Chinese informal export embargo in 2010. Japanese companies and the public corporation Japan Organization for Metals and Energy Security (JOGMEC) now have significant stockpiles—up to three years' worth for some—of processed rare earths. JOGMEC has also subsidised the successful partnership between the trading house Sojitz and Australian company Linus that supplies roughly one-third of Japan's heavy rare earth needs. Japan also recycles about a third of its critical mineral Gallium, reducing dependence on China. These measures have all required government support.

This suite of changes has been operationalised through adjustments to Japan's institutional architecture, reflecting the country's whole-of-government approach to economic security. Dedicated economic security units were established within METI and the Ministry of Foreign Affairs in 2019, followed by the creation of an economic security team within the National Security Secretariat in 2020 (Armstrong, Solís and Urata 2025). These reforms resolved a deeper coordination problem: while METI had increased regulation on inward foreign direct investment, the administrative capacity needed to assess sensitive technologies was dispersed across several ministries. Strengthening the National Security Secretariat's economic security function allowed the government to centralise oversight, reducing gaps in how national security risks were evaluated. Centralising this function has also made it easier to coordinate with foreign partners, particularly the United States. Its early focus on the COVID-19 pandemic, alongside rising US–China tensions and rapid technological change, underscore the breadth of its remit and the likelihood that the division will need to expand in future (Tobita 2020). The appointment of a Minister in Charge of Economic Security in 2021 elevated the issue to the level of cabinet (Armstrong, Solís and Urata 2025). This signals its importance to Japan as a policy priority—raising broader questions about how the country's strategy differs from its previous approach to industrial policy and at what cost.

V. Continuity, Change and Trade-offs

Japan's current industrial policy draws on parts of its postwar developmental experience, but under very different economic and strategic conditions. Much of Japan's institutional setup is familiar from its postwar history: the state continues to identify priority sectors, coordinate with firms and deploy public resources at scale to influence the structure of industries. However, earlier industrial policy was conducted in the context of catch-up growth, where Japan attempted to build domestic capacity in technologies and industries that had already proven central to economic modernisation elsewhere, such as heavy and chemical industries. The policy direction during catch-up growth was clearly established: policymakers could identify sectors associated with high productivity and export competitiveness in other countries, and work to replicate them domestically. Advanced economies, including in the United States and Europe, offered proven technologies that Japanese companies could adopt. In this context, the Japanese government had a clear basis for selecting industries and

designing policy instruments, drawing on well-established patterns of industrial development in other advanced economies. But Japan can no longer apply this model since, as an advanced economy, it operates close to the technological frontier. Under these conditions, lessons guiding direct support of industries with subsidies is less settled, as peer economies face the same uncertainties and there is no clear model to follow. Innovation becomes more important and this makes industrial policy more speculative, both in terms of the sectors it targets and the design of the policies used to support them.

These differences are most evident in the contrasting approaches taken towards revitalising Japan's semiconductor industry. The use of large subsidies to attract TSMC to Japan resembles the older catch-up logic: Japan is attracting a proven global leader in the semiconductor industry and embedding it within the domestic industrial ecosystem. Moreover, TSMC's Japanese facilities will be manufacturing legacy chips for consumer electronics, automotive and industrial applications (Negrine, Findlay and Armstrong 2025). While their proven nature reduces risk by avoiding uncertain research-and-development investments, their relevance to artificial intelligence remains limited, with meaningful application concentrated in only the most advanced chips produced in these factories. This approach echoes Japan's approach to industrial policy during the high-growth era, when technologies successful in advanced economies were imported to drive domestic expansion[4]. By contrast, Rapidus reflects an attempt to build new capabilities at the technological frontier, rather than scale established technologies. Its focus on developing next-generation 2-nanometre semiconductors by 2027 involves far greater uncertainty. Success depends on closing a substantial technological gap with incumbent firms, securing access to advanced equipment, attracting specialised labour and achieving commercially viable production (Thorbecke 2024; Grant-Chapman and McGee 2024). Unlike the TSMC project, which builds on existing capabilities and demand, Rapidus requires significant innovation and the creation of a competitive ecosystem that has not yet been fully established. This orientation of government intervention raises the stakes of industrial policy, since its outcomes are more uncertain and success is far harder to secure. Government, with public funds, not the private sector, is betting on a particular frontier technology.

[4] Move footnote 5 to here?

This extends to the widening group of sectors targeted under Japan's economic security agenda, which amplifies an already heavy fiscal burden. Japan carries one of the highest public debt burdens in the world, with central government debt exceeding 200 per cent of GDP (IMF 2026). While the country's debt-to-GDP ratio may decrease in the coming years if economic growth exceeds the interest rate or if inflation remains relatively high, structural features of its economy, including an ageing and shrinking population and near-zero economic growth, limit the economic case for sustained industrial subsidies. The scale of state support raises questions about the long-term sustainability of such commitments. While Japan's industrial subsidies are often framed as a form of insurance against risk, it comes with costly premiums. This concern is compounded by the danger of subsidy lock-in. Once a project receives large-scale public backing—and is framed as a national strategic priority—withdrawing funding becomes politically difficult. If Rapidus fails to meet its ambitious commercial targets, the Japanese government may be tempted to continue to support it through expensive subsidies rather than acknowledge failure and reorient its industrial policy. The familiar maxim that governments are bad at picking winners, but losers are good at picking governments, is especially relevant in assessing Japan's industrial policy (Wade 2017). The same logic applies to the other industries targeted by Japan's renewed industrial policy drive.

Japan's economic security policy also assumes that greater resilience requires a retreat from open markets. There is broad recognition that the Economic Security Promotion Act (2022) and related policies will impose costs on businesses in pursuit of national security (Armstrong 2024; Ando, Hayakawa and Kimura 2024). METI's (2023) *White Paper on International Economy and Trade 2023* explicitly sets out the government's institutional view, stating that government policy must "strik[e] the right balance between free trade regimes and economic security." And the subsequent 2024 iteration identifies several of the "challenges involved in reconciling risk reduction and supply chain optimization" (METI 2024). This frames economic policy as a trade-off between openness and protection, where reducing exposure risk requires accepting some loss of efficiency through, for example, higher costs or restricted market access. In earlier periods, Japanese industrial policy was oriented towards economic development, with intervention explicitly used to promote economic growth—though the extent to which these outcomes can be attributed to policy rather than broader economic conditions remains debated. The current approach instead reflects a willingness to accept self-imposed constraints on trade and efficiency in the name of national security, enabled in part by Japan's position as a wealthy, advanced economy. The perceived credibility of this approach is clear

in international assessments of Japan's economic security policy, an area in which the country has been variously described as a "frontrunner," "pioneer" and "first mover" (Edmonstone 2024; Nishimura 2024; Tiberghien 2024).

This framing treats efficiency and security as substitutes, where more efficiency entails less security (or resilience) and vice versa. However, in practice, the two can be mutually reinforcing. Greater participation in global supply chains can constrain coercive behaviour from foreign actors by increasing the costs of economic disruption (Armstrong 2025). If Japan and other third nations reduce interdependence with China and the United States and, as a result, their integration into the global economy in the name of economic security, that may increase geopolitical risk, since the US and China's deep involvement in global supply chains gives them stronger incentives to maintain stable and open trade. This makes continued engagement, centred on protecting a rules-based international order, a more effective approach to de-risking (Armstrong 2025). Participation in open, non-discriminatory trade also increases Japan's economic options, reducing reliance on domestic supply chains—which are often fragile, especially those in their nascent stages—and making the country less vulnerable to external shocks. But most importantly, prosperity itself is perhaps the greatest hedge against geopolitical risks. By increasing incomes and government revenue, and with a more dynamic private sector, a more prosperous and free-trading Japan is better able to weather the risks of increasing geopolitical insecurity. Greater prosperity makes Japan's government, private industry and citizens themselves less vulnerable to coercive economic action from foreign actors and better able to respond to supply chain disruption.

VI. Conclusion

Japan's industrial policy as part of its economic security policy sits uneasily alongside its long-standing support for an open, rules-based trading system. For decades, Japan has been one of the system's principal beneficiaries, relying on free and fair markets to sustain its exports and procure energy and strategic raw materials. Following the United States' withdrawal from its leadership role in the multilateral trading system during Trump's first term, beginning in 2017, Japan briefly stepped into that position. Japan's several achievements towards the end of the decade—including leading

the conclusion of the CPTPP, and being party to the conclusion of RCEP and the Japan–European Union Economic Partnership Agreement, one of the largest bilateral economic agreements—helped preserve the norms of economic cooperation at time when Trump's administration was eroding confidence in the international order (Armstrong and Urata 2023). However, this resolve did not prevent Japan from selectively deviating from multilateral norms when external pressures were at stake, for example in its measures against South Korea in 2019.

The broader question is whether Japan's revival of industrial policy itself violates the norms of the multilateral system. Japan's significant support for domestic industries is justified by an appeal to "economic security". As Keitaro Ohno, the former State Minister of the Cabinet Office responsible for economic security, said of the country's approach: "Japan has never changed its stance toward promoting free trade. *But* it has selectively and strategically strengthened supply chains for those goods and services related to the survival of the nation" (Chou 2024, emphasis added). From Tokyo's perspective, these objectives are not in tension. The international economic environment has changed dramatically over the past decade. Rising geopolitical tensions centred on the growing US–China rivalry, worsening climate pressures and the economic vulnerabilities exposed by the COVID-19 pandemic have blurred the line between economic policy and national security. In this context, Japan views targeted economic interventions as necessary to mitigate the strategic vulnerabilities created by globalisation and the interdependent global economy it has produced. On this view, such measures are merely a pragmatic adaptation of multilateral trade norms in response to a changing international environment. China and the United States, along with many other countries, have adopted a similar approach (Armstrong, Solís and Urata 2025).

Addressing the emergence of a new industrial policy requires strengthening international disciplines on subsidies, ensuring they are fit for the evolving economic security environment. Without such constraints, there is a growing risk of a subsidy race, as countries seek to reshore key industries and establish a lead in technologically advanced industries—all under the banner of economic security. Disciplines will prevent such a beggar-thy-neighbour race to the bottom and help restrain countries from offering fiscal support they ultimately cannot afford. A growing body of evidence suggests that such a race has already begun, with China, the European Union and the United States exhibiting tit-for-tat responses to one another's discriminatory subsidy measures (Evenett and Fritz 2021). Japan serves here as a cautionary tale: while the country's renewed industrial policy efforts have spurred

domestic investment and innovation in critical sectors, they have generated new fiscal pressures and eroded its integration with the global trading system. The policies may, ironically, undermine the very security they sought to protect. By discouraging states from implementing subsidies under this new form of industrial policy, strengthened international disciplines will help to protect them from the negative externalities of a subsidy race. But stronger regulations will also allow members of the international community to collectively decide which forms of government intervention are legitimate in addressing shared global challenges, including climate change. Overall, stronger disciplines will help to limit the negative spillovers of industrial policies and enhance their positive spillovers.

Strengthening disciplines on subsidies, one of the major tools of industrial policy, requires a dual approach: advancing stronger rules through regional agreements, and restoring the dispute settlement system and strengthening disciplines within the WTO. The pursuit of stronger subsidy disciplines will be most effective through plurilateral or regional agreements such as the CPTPP and RCEP for eventual adoption in the WTO. The smaller groupings makes the successful passage of disciplines more likely. In parallel, the international community should work to restore the functionality of the WTO Appellate Body and other features that have undermined its operations in recent years, including its rule-making and negotiation processes (Hughes 2023). This work has already begun, with a group of WTO members, including Japan, establishing the Multi-Party Interim Appeal Arbitration Arrangement (MPIA) as a substitute for the dysfunctional Appellate Body and initiating negotiations on rules concerning e-commerce, investment facilitation, and other issues under the Joint Statement Initiatives.

Japan's revival of industrial policy underscores the need for multilateral action. This paper has demonstrated how the Japanese government's industrial policy has shifted from chasing export growth to dealing with supply chain vulnerability, US–China rivalry, technological competition, energy insecurity and the breakdown of global trade rules. This has yielded a wide-ranging and costly series of market interventions that have resulted in a series of new vulnerabilities for the country as it faces increasing fiscal and demographic pressures. Japan, therefore, offers both a model and a cautionary tale: its policies show how advanced economies are learning to navigate a fractured global environment, and why stronger subsidy disciplines and a renewed commitment to the rules-based economic order are necessary to preserve both prosperity and security. Japan has the economic

weight and the diplomatic credibility to play a leadership role there. Questions remain about the long-term fiscal sustainability of these interventions—and the extent to which strategic vulnerabilities can be managed without undermining the openness on which Japan's prosperity depends. Its experience shows that a single-minded pursuit of economic security through de-risking can, in fact, increase the risks facing an economy. Japan's approach has demonstrated that, without coordinated multilateral frameworks to manage strategic competition in the age of economic security, the race to de-risk ultimately can become a race to the bottom.

The new industrial policy centred on economic security marks a shift from the growth-oriented approach of Japan's past industrial policy during its high growth catch-up phase of development to one focused on strategic autonomy and indispensability. The latter approach has tasked the government with a dual mission: risk mitigation and growth promotion. To achieve this, the government is attempting to achieve defensive economic security with state-assisted technological innovation and international competitiveness. Japan's new industrial policy now stands at a turning point. Whether it can successfully integrate technology, industry, human resources and international cooperation while maintaining openness around the axis of economic security will determine the sustainability of Japan's prosperity in the decades to come.

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