

Roundtable with Prof. Asei Ito, Prof. Kazuto Suzuki, Prof. Yasuyuki Todo & Yo Okada

# Roundtable on the White Paper on International Economy & Trade 2022: Economic Impacts of Russia's Aggression Against Ukraine

By Japan SPOTLIGHT

In our Roundtable discussion on the White Paper on International Economy and Trade 2022, the main issue was the economic impacts of Russia's aggression against Ukraine. Our participants were Prof. Kazuto Suzuki of the Graduate School of Public Policy at the University of Tokyo, an expert on international politics, Prof. Asei Ito of the Institute of Social Science at the University of Tokyo and Prof. Yasuyuki Todo of Waseda University, both distinguished economists. The Roundtable was moderated by Mr. Yo Okada, former director of the Policy Planning and Research Office at the Trade Policy Bureau of METI, who authored this White Paper, and now counsellor of the Japanese government's Secretariat of New Form of Capitalism Realization Headquarters.

(Online Roundtable on July 12, 2022)

## Participants



*Prof. Asei Ito*



*Prof. Kazuto Suzuki*



*Prof. Yasuyuki Todo*



*Yo Okada*

## Introduction of White Paper on International Economy & Trade 2022

**Okada:** The theme of the White Paper 2022 is economic risk caused by geopolitical uncertainty and the challenges and opportunities for international trade in responding to the changes brought about by this risk to economic structure, technology, geopolitics and values. We analyze in particular as a central subject the “economic impacts of Russia's aggression against Ukraine”. On the challenges and opportunities for international trade, we analyze issues relating to the construction of resilient global supply chains reflecting common values as well as economic growth opportunities through innovation, and consider four particular trends that are accelerating globally.

### Global economic impacts of Russia's aggression against Ukraine

After Russia's invasion of Ukraine, the G7 and other developed countries promptly enacted unprecedentedly large-scale economic

sanctions and have very quickly promoted reconsideration of their economic and political relations with Russia.

In contrast, most emerging and developing countries refrained from decisive action, including economic sanctions against Russia, and have been neutral in considering their economic and political relations with Moscow. China, presumably believing there would be no area where China-Russia cooperation is prohibited, continues to collaborate with Russia, and among the other G20 members, Indonesia, this year's chair nation of the G20, is opposed to excluding Russia from the gathering in 2022, insisting that all the members are to be invited. Turkey, though condemning Russia's invasion of Ukraine, is not joining EU-led economic sanctions against it. Mexico, though also condemning the invasion, maintains neutrality and is refraining from sanctions. Brazil is also staying neutral and has opposed sanctions, which could possibly have a negative impact on the Brazilian economy, though ready to collaborate with developed countries that have imposed sanctions against Russia. Brazilian Foreign Minister Carlos Alberto Franca

announced a clear objection to excluding Russia from the G20. South Africa has been also supportive of Russia in proposing a “Humanitarian Resolution” in the United Nations without actually referring to Russia.

Among ASEAN countries, Singapore is the only one designated as an unfriendly country by Russia because of its announcement of sanctions against Moscow. Except for Singapore, the countries in cooperation with the G7 in imposing economic sanctions against Russia are Australia and South Korea in the Asia-Pacific area, and a limited number of other countries.

It is also true that Russia’s invasion of Ukraine has unprecedentedly added to mounting concerns about the division of economies in the world since the end of the Cold War era. Polarization has already been occurring and the war has accelerated this trend, and thus the structural changes in the international economy. I think this event could be a historical turning point in the international economic order.

In terms of the ranking of the percentage of a country’s nominal GDP to the global total, Russia is 11th and Ukraine is 54th. Russian nominal GDP accounts for only 1.8% of the global total and is smaller than South Korea’s; however, it is a major supplier of many important staple commodities such as wheat and corn, as well as fertilizers and energy in general. Depending on the degree of a country’s reliance on trade in such products with Russia and Ukraine, the impacts of economic sanctions will differ significantly.

Russia’s exports of wheat rank first in the world, and Ukraine’s exports of wheat and corn rank fifth and fourth respectively. Developing countries in the Middle East and Africa are particularly dependent upon imports of these products from the two countries. In extreme cases, Kazakhstan, Qatar, Armenia, and Lebanon rely nearly 100% on Russia and Ukraine for their consumed wheat imports. In addition, sub-Saharan countries depend on imports for 85% of their wheat, mostly from Russia and Ukraine, and the rise in global food prices is likely to be reflected in domestic price rises of about 30% in those countries, which could also suffer from supply shortages.

Given that the Ukraine crisis is not expected to be resolved soon and we cannot tell how long it may continue, its economic impact will be expanded to the whole world through cost-push inflation due to restricted supplies of commodities and soaring prices, as well as interest rate hikes in developed countries to cope with inflation. Prices of oil and natural gas are rising as well as the forward prices of wheat and corn. Since the Russian invasion, prices of fertilizers such as urea or potassium chloride have also risen and we are now facing a food security threat.

The predicted economic growth of emerging and developing countries and the euro area, which is highly dependent on Russian

energy, will be much lower in 2022, and growth in the countries at war, “both Ukraine and Russia”, is plummeting drastically, needless to say. In particular, with the effect of the sanctions, we have already seen signs of economic stagnancy in the monthly economic data from Russia, which is blaming any negative effects on the wider global economy precisely on these sanctions by the West. This passing of the buck seems to be working to some extent.

### Four trends accelerating globally

The geopolitical environment has been deteriorating, supply restrictions and rising prices of commodities and natural resources, accelerated by both the Covid-19 pandemic and the Ukraine crisis, have resulted in global inflation and a worsening economic situation in emerging countries, and the Chinese economy has been slowing down with its zero Covid policy initiatives. All these factors have increased uncertainty in the global economy. Real global economic growth has slowed down drastically compared with 2021, with commodity prices soaring and inflation rates increasing.

The digital transformation, increased geopolitical risks such as the greater need for economic security, enhanced global commitment to common values such as the environment, climate change and human rights, and a shift in public policy to an industrial policy have all been accelerating in response to this heightened uncertainty. I think these four trends will influence the future trajectories of international relations and the global economy, and create further uncertainty in business management while changing the sources of corporate value-added.

In particular, on geopolitical risks and commitment to common values, differences in policy stances have been producing bloc-based rule-making especially on the issues of climate change and human rights. Rule-making has been affecting the structure of costs, capital procurement and conditions of business transactions and competition. With this, the global market has become progressively divided into blocs.

Furthermore, with the trend of strengthened national industrial policies, large-scale markets have been built up in specific sectors such as green-related industries, aviation and aerospace, or semiconductors in the United States and the EU. Thus, there will be various opportunities for businesses trying to gain a market share, depending upon the host country’s policy initiatives.

Under such circumstances, it would be desirable for a company to orient its business towards raising its profits and earning capacity by actively promoting reform of its business model, encouraging product differentiation or enhanced value-added as well as efficient business operations, instead of cost savings or provision of low-priced goods as previously pursued. In addition, I think it will be important to realize a new business model and industrial structure to

create higher value-added by taking advantage of the four trends mentioned: prompting corporate transformation by digitalization, exploiting the opportunities created by the public sector, and turning economic security and the common values into core business value.

As for the Japanese government, it needs to engage in discussions on the international economic order at the G7 and other venues at an early stage to help achieve an environment where Japanese businesses can be engaged in the social implementation of new technologies in the US and European markets. This would be encouraging support for Japanese businesses. It is also important for the Japanese government to play a bridging role between Asian countries and advanced countries for comprehensive rule-making to achieve common values, while considering current conditions of Asian countries. Japan should also promote common values rooted in its own experience, such as with medicare or caregiving in an aging society, for the rest of the world's interest and set up an agenda for a market to be born from these challenges.

### **Trade policy based on the four trends and challenges and opportunities for Japan**

In this White Paper, we made an analysis and policy proposals largely on two issues: construction of resilient global value chains reflecting common values, and Japan's retarded innovation and how it could gain growth opportunities against such a background.

On the first issue, our analysis of the current status of global value chains concludes that Japanese businesses have been working steadily on diversification of production sites and suppliers in Asia as their response to geopolitical risks, the pandemic and natural disasters, and resilient supply chain construction is making good progress.

For example, the share of the Japanese manufacturing industry's foreign direct investment in China to the total in Asia had been kept high, but since 2012 when the Senkaku Islands issue emerged again, it has been declining steadily and its investment in so-called China+1 countries like Thailand, India and Vietnam has increased.

On the second issue, it is becoming important to consider economic security seriously and in this regard a reduction in dependency on specific countries for key strategic items like semiconductors or batteries, appropriate management of sensitive and emerging technologies and prevention of their leakage are vital. Also in terms of stable energy supply, it is becoming more important to develop upstream natural resources, including domestic resources.

On the third issue, supply chain management is now extremely complicated, as businesses are increasingly forced to meet a variety of requirements, such as decarbonization, other environmental issues and human rights, with a firmer interest in common values.

Digitalization of such complicated supply chain management and enhancing its visibility by using data would lead to the build-up of a common database not only in Japan but also in the whole of Asia where Japanese businesses have a network of supply chains. It will be important to lead this to value creation.

On the fourth issue, we made an analysis on start-up companies on the issue of Japan's retarded innovation and their way of gaining economic growth opportunities. While global venture capital investment from 2020 until 2021 almost doubled, Japanese investment, though increasing, was much smaller than other countries, in particular other Asian countries such as China and India. It is also true that facilitation of ecosystems to support start-ups in terms of human resources, capital and place in Japan is far behind the global standard. It is important to promote such ecosystems to achieve mutually beneficial relations among start-ups and their supporters. Japanese businesses should build up active digital transformation (DX) alliances with the Asian countries with high growth potential and invest in Asia and collaborate with them in creating value. This is important for them to get new growth opportunities.

For example, Mitsui & Co. has been investing in IHH Healthcare, a Malaysian large hospitals group, since 2011. Sumitomo Corp. also invested in a large Vietnamese managed care group in 2021. These are both cases of supporting Asian DX in the domains of medicare and caregiving, and I hope support in these areas will expand.

On the fifth issue, although Japan has been investing in R&D substantially, investment in intangible assets, especially in human capital and in organizational reforms, has been low compared with other developed countries. For example, the calculated percentage of intangible assets to the total value of listed companies is 80% in the US and 70% in the EU, but in Japan it is only 30%. Japan must strengthen efforts to raise investment in intangible assets, in particular, in human capital.

Finally, with the accelerated development of new technologies such as AI and robots, we increasingly need to cope with challenges like greater unemployment or expanding income gaps and inequality. It is important for Japan to fully utilize new technologies while responding to these challenges and promote social implementation of these technologies, drawing on the experience of Asian countries undergoing rapid growth.

### **Increasing the Effectiveness of Economic Sanctions Against Russia**

**Okada:** Prof. Suzuki, what do you think is to be done to increase the effectiveness of economic sanctions against Russia while it is occupying global choke points in energy and food?

**Suzuki:** Economic sanctions would differ according to their objective, such as a change from the regime of Vladimir Putin leading to the end of the war or creating a situation that makes it difficult for Russia to continue its military actions even without regime change. The current sanctions are aimed at achieving whatever is possible now. If the sanctioning nations try to enhance their effectiveness, they would have to impose sanctions that would be rather painful for themselves as well. In short, there would be rising prices of gas and other fuels and food items that will have a certain negative impact on their economies. So I think it will be difficult for the West to change the Russian regime without stricter sanctions, and worrying about their negative impact on their economies or political objections to them. The current sanctions against Russia are aimed at raising the cost of maintaining the war, but they could result in provoking Russia to target choke points for the West before they can work effectively. It is important for the West to build up economies that could be resilient to shocks as well as domestic political negative reactions.

**Okada:** Russia has promoted the narrative that economic sanctions by the West are responsible for rapidly rising energy and food prices in emerging and developing countries. I guess those countries facing price increases may understand such a narrative to some extent and ask Russia or China for help. To avoid a divide in the global economy possibly caused by the Russian narrative, what do you think must be done by the West, in particular Japan?

**Suzuki:** The main factor behind the current rise in energy prices is certainly the import ban on coal and oil from Russia. As for food prices, the main reason for their rise is Russia's blockade of the Black Sea to ban exports from Ukraine. So we cannot simply say the economic sanctions of the West are the reason for rising food prices. There are a large number of emerging and developing nations dependent on food and energy sources from Russia that officially accept this Russian narrative, but with a better understanding of what is happening today I believe this narrative would not lead directly to a division in the global economy.

A total of 141 countries supported the UN General Assembly resolution blaming Russia for the war. There are also many emerging and developing nations depending on imports from the West and those nations will maintain this interdependency hereafter regardless of their relations with Russia. This narrative was created by Russia to identify whether a nation is on its side or not. Russia is certainly intentionally provoking confrontation between the West and the supporters of Russia by making a clear distinction between the two. The West should organize a foreign policy strategy to clarify that rising prices of food items are due to Russia's invasion of Ukraine.

**Okada:** In the international economy where networks of interdependency among trade, investment and finance are prevalent, some countries occupying nodal points could weaponize this interdependency by using its leverage. At this moment, it seems the West and Russia are trying to weaponize their interdependency on each other. Japan does not occupy any nodal points or have much leverage, so what do you think Japan should do in this situation?

**Suzuki:** Japan is a net importing country of food and energy resources and it is important for Japan how to overcome such vulnerability. It is rather difficult for Japan to achieve self-sufficiency completely in food and energy. I think the policy to be adopted by Japan should be storage of minimum natural gas supplies and strategic stockpiling of food, and also demand-side control of energy and food distribution, such as saving electricity, rather than rationing. More importantly, as a country with such vulnerability, Japan should do its best to consolidate the free trade system in order to secure stable supplies of energy and food. Diplomacy will also be important in order to prevent a country like Russia from abruptly starting another war.

**Okada:** Since the invasion of Ukraine, we have seen growing concerns about economic divisions in the world economy. As our White Paper describes, this could accelerate structural changes in the international economy on the back of multipolarization, with rising unilateralism and concerns about economic security. This could eventually lead our international economic order to the historical turning point. How do you think the international economic order will change in the aftermath of the Russian invasion of Ukraine?

**Suzuki:** I think it will be difficult for us to maintain an international economic order on the basis of optimism about free trade. There would be rising risks of self-centered foreign policies or the weaponization of economic interdependency. To avoid them, it will be important to ensure economic security. If a nation is economically vulnerable, it will need policies to protect its economy that is sensitive in terms of economic security with certain limitations on free trade and carefully manage exports of goods which have their own technological advantages.

But I do not think economic security measures should be adopted in all the aspects of trade. In the future international economic order, I think restoration of a malfunctioning WTO is less likely and regional economic cooperation frameworks such as the CPTPP or RCEP would be more likely at its center. In this way, there is a possibility of a free trade-oriented economic order built up in feasible areas or among economic partners with mutual trust instead of the WTO. Free

trade may be narrowed geographically from a global scope to regional ones.

Another direction would be to focus on distinctions between the items relevant to free trade and those that are not. For example, toys or clothing do not affect a nation's economic security and thus should be traded freely. But specific crucial items in certain limited areas such as rare earths or semiconductors designated by the Economic Security Promotion Law in Japan should be subject to government management. We will have such a two-layered structure of trade – free trade and managed trade – but the managed trade must be minimized as much as possible.

## Responses to Digitalization & Global Commitments to Common Values

**Okada:** Entering the 21st century, especially after the 2010s, the exponential growth and development of digital technology and global data flows under the Fourth Industrial Revolution driven by IoT or AI have been changing economic rules. Innovation is being encouraged with newly emerging technological development and free data flows have become crucial as sources for tech start-ups or value-added. DX is a key for business success in expanding customers, providing them with value, and increasing investment in intangible assets such as human capital, as well as enhancing DX or R&D investment and achieving business reforms and raising productivity. The White Paper mentions that it will be important to create new business models and industrial structures producing more value-added with the utilization of data analytics of cross-border data flows, formation of digital ecosystems, alliances among start-ups and Asia DX.

On commitment to common values, climate change, circular economy, biological diversity, environmental protection, health, human rights and equality are among those that feature significantly in public policy, as well as consumers markets and financial markets. Against this background, businesses are expected to pursue not only added value for shareholders but also for all kinds of stakeholders such as customers, employees, local communities, the public sector and the natural environment in alignment with their purposes. Young consumers today are starting to buy goods and services in accordance with social and environmental concerns. I think it will be increasingly important for a company to create core added value from respect for such common values and build new comparative advantages instead of pursuing only corporate social responsibility activities, incidental ones annexed to the company's main business. For example, Unilever is expanding sales of detergents for dish washing enabling the saving of water as an environmentally friendly product.

It is also important to make rules on common values since they

would affect a company's cost structure, capital procurement and conditions of competition. Prof. Ito, what do you think about these issues, in particular the challenges and opportunities born from them for both the government and business to tackle?

**Ito:** Digital terminals have become prevalent these past two decades among developing and emerging nations and this completely changes the whole world. According to the International Telecommunication Union (ITU), the number of mobile phone contracts in Japan was 66 million, the third-largest in the world 20 years ago, but it is now eighth in 2020 when in Japan more than 200 million terminals are working, much more than its population. In Nigeria, they already have 200 million digital terminals in use.

In 2005 Thomas Friedman, a well-known columnist, introduced an episode in his book *The World Is Flat* that discussed how American white collar jobs were being outsourced to India. So digitalization from the perspectives of developing and emerging nations at that time was nothing but the informationalization of developing economies to become subcontractors for American white collar labor.

However, the situation has significantly changed in this decade. I call it “digitalization of the South for the interest of the South” where human resources, capital funds, entrepreneurs and challenges are all on the side of the emerging and developing nations. Even without help and support from the North, their own entrepreneurs and technologies are starting to resolve the challenges. In such circumstances, digitalization is commonly set as a goal to be achieved in any country's mid and long-term plan of national economic development. It is a new challenge for Japan to explore what to do in the future under these circumstances. We will need to start thinking about a strategy on the assumption that Japan is “not an advanced nation in terms of digital economy” but is possibly “a partner for collaborative creation”.

In other words, Japanese businesses need to develop their expansion into emerging markets through investment in the host country's business firms or strategic alliances with them, as they cannot achieve it on their own like the giant IT software companies such as Google, Facebook, Apple and Amazon. It should also be noted that Japan itself is behind the global trend in its domestic digitalization. In this light, I think we must think about utilizing digital collaboration with emerging nations. Meanwhile, Japan's presence in ASEAN is extremely limited in terms of investment amounts or M&As. For example, the acquisition of ventures in Southeast Asia by Japanese firms was smaller than that of Thai companies between 2017 and 2021.

On Japanese companies' engagement in promoting common values, I think the issue is whether they can promote what they have

achieved so far to the rest of the world. For example, resource recovery in Japan has been greater than the global average, but it is another question whether Japan can promote this well internationally.

Human rights due diligence is one of these common values. But there is concern that a strategic partnership between China and Russia will be strengthened in the wake of the Russian invasion of Ukraine. Of course, China will have to maintain its close trade and investment relations with the West, but on the other hand it is working on strengthening its partnership with Russia. In a way this is a strategic ambiguity.

At the same time, I think there is a possibility of China's permanent support for Russia financially and materially. I am very concerned about what will happen then. Japanese companies did not necessarily exit from China when the territorial dispute over the Senkaku Islands reignited. Most Japanese companies stayed in China and remained patient. Even with the US-China confrontation worsening, Japanese companies have not largely exited from the Chinese market. The reality is that many companies will wait and see what happens.

**Okada:** It is certainly true that Japanese companies have not been completely leaving China, though they are trying to diversify their markets and host countries. According to one survey, only a few percent of respondents said they would need to exit China or reduce their business activities there. So the exiting companies remain very few. What do you think is the best way to deal with the gigantic Chinese market and production sites?

**Ito:** I think there is a misunderstanding of China due to the lack of precise information and policy dialogue. For example, there are extremely simplistic arguments about China's protection of intellectual property rights, such as China's claim that it has a market friendly intellectual property rights system or Western nations' argument that such rights are stolen from confidential business information.

Though it is true that various regulations in China are devised to encourage foreign firms to invest in China or procure local contents or promote R&D in the Chinese market, it is far from the reality that all foreign companies in China have had their business secrets stolen. It is also true that China's intellectual property rights system has recently been developed quite well. I think we need a precise understanding and dialogue to overcome such simple and prejudiced arguments.

On policy dialogue, have there been any venues for exchanges of views over China's application for membership of the CPTPP between the Japanese and Chinese governments since China applied

in September 2021? I have been wondering whether the Japanese government has ever mentioned its specific concerns to the Chinese government about its membership of the CPTPP. Different opinions could always emerge and exchanges of different policy views should be arranged at any time.

**Okada:** What do you think the government and businesses care about most in promoting the ideas advocated by the White Paper such as the creation of an Asian-wide database, active DX alliances with Asia and joint value creation?

**Ito:** There is an argument that data sharing in supply chains will be necessary for surveillance of the regulations for the business environment on human rights. If it is necessary to have precise observation of forced labor or child labor in global supply chains, then I think it is desirable to accommodate a low-cost database. On the other hand, for data sharing to create new businesses by using health and medicare data or business transaction data, we will need a completely different database system. So in my view, depending upon the goals for database sharing, there would be divided plural blocs for such an Asian-wide data base construction idea.

On the issue of DX alliances with Asia, we should develop a market for the digital products of Japanese companies mainly in Southeast Asia, especially in medicare, health care and caregiving. These domains are interesting, since Japanese companies already have know-how in the domestic market due to the aging society in Japan. So such know-how could work to some extent in helping Japanese business survive in a time of digitalization. However, judging from the speed of investment or business development by Japanese firms at this moment, there is a risk of Japan failing to be even a "partner for collaborative creation of values for Asia" from the perspective of Southeast Asia. Now is the time to restart efforts for business development in Southeast Asia that were disrupted by the pandemic.

**Okada:** It is certainly true that the presence of Japanese businesses has been reduced by the disruption of investment and communications during the pandemic, according to Southeast Asian countries. A Japanese Foreign Affairs Ministry survey tells us that more countries in Southeast Asia refer to China as a more important partner than Japan. So I believe we should seriously redouble our efforts to consolidate relations with Southeast Asian countries.

## Active Role of Industrial Policy

**Okada:** Among large countries like the US, China, European countries and Japan, in advanced technology areas such as green technology, the role of active industrial policy is being reconsidered.

This is justified by economics too, given that private sector investment alone based on private returns would be insufficient, while decarbonization is a global public good and the green technology that could contribute to it would produce larger social returns than private returns. Technological progress is path-dependent and thus promotion of industrial policy will be needed to impact the technological revolution in the green industry and make existing technologies causing pollution obsolete. In these respects, industrial policy can be justified.

Prof. Todo, what do we need to keep in mind to achieve the success of active industrial policy? In particular, what do you think about strengthening industrial policy in the semiconductor industry?

**Todo:** In principle, industrial policy in the narrow sense – promoting specific policies to support limited industrial sectors – seems to have been ineffective so far and this may be true hereafter as well. For example, it is said that China's industrial policy has achieved success, but data analysis shows us that while an industrial policy assuming value creation by collaboration between the private and public sectors is successful, a protectionist-oriented policy is not necessarily so. China's industrial policy supporting semiconductors, though implemented on an extremely large scale, cannot be considered very successful as it fails to promote nationalization of production. It should be noted too that industrial policy to encourage competitiveness in limited sectors would also not be so effective.

The second point is that there seems to be a focus on production rather than innovation in the current industrial promotion policy, but this is not so effective in terms of industrial development. I think China should give more thought to innovation, as it is a source of industrial development.

In reality, the so-called policies for strengthening supply chain resiliency of the US or EU contain not only policies to attract production sites but also to strengthen the capacity for innovation. This is not included in Japanese industrial policy.

Concerning R&D in Japanese companies, the level is high but the economy is nevertheless weak. There are issues to be tackled, and I think one of them is alliances with partners overseas. According to my research, international joint research would enhance a country's innovation capacity. In the area of research on the pandemic, international cooperation has played an extremely important role. According to the OECD, as Japan made little contribution to such cooperation, its achievements have been fairly limited. I think promoting international joint research or strengthening knowledge-based alliances will be increasingly important in the wider sense of industrial policy.

Looking at Japan's semiconductor sector-related policies today from this perspective, the main recent development has been to

attract a factory of the Taiwan Semiconductor Manufacturing Company (TSMC) to Kumamoto Prefecture, but as it is a production-oriented policy I am afraid that we cannot value it very highly. Japan has developed lots of policies to attract high-technology companies to Japanese regions so far, but they have had little effect.

However, taking advantage of the TSMC factory's introduction to Kumamoto, Japan could enhance its innovation capacity by adopting the following two policy measures. The first one is to strengthen the link between the TSMC factory and Japanese suppliers and enhance its innovation capacity. There are many research outcomes telling us technology prevails through supply chains, and with this policy the TSMC's impact would be much larger.

However, in order to achieve a smooth alliance, we would need policy intervention such as information provision for finding relevant partners or preventing leakage of confidential information from them.

**Okada:** In the US and EU, there are some government-led initiatives to enhance the resilience of supply chains by reshoring or friendshoring (alliances with friendly countries) in the light of recent geopolitical risks, such as the US-China conflict, the pandemic and Russia's invasion of Ukraine, though the build-up of business-led global supply chains has been progressing so far along with free trade principles. Japan will have to join such renewed global supply chains. What do you think about this development? Such government initiatives could distort business decisions and harm efficient management. Could you tell us what the government and businesses need to consider in order to promote the resilience of supply chains while maintaining their efficiency?

**Todo:** It is certainly true that the risk of supply chain disruption is increasing. But I do not think it is relevant to promote reshoring (bringing back overseas production sites to Japan) to cope with it. Reshoring is not an efficient business decision and would be contrary to globalization, which Japanese businesses have been taking advantage of in pursuing the most efficient means of production. In addition, there are so many risks in Japan as well, such as natural disasters like big earthquakes. They may have to do it to some extent, but reshoring alone would not fix the issue. Friendshoring would be much better and I believe that encouraging diversification of business directions would be most effective in fixing this issue.

It is crucial to lower the dependency of Japanese businesses on China by this diversification of business partners and enable them to replace a partnering country with another country in cases of emergency. This diversification would have costs for a Japanese company as it would need information about replacement countries. To reduce these costs, JETRO or Japanese local governments would

need to provide them with the necessary information for such diversification as well as support them by business matching.

In addition, assuming that friend-shoring will be important in the future, Japanese businesses would have to seek partnerships with nations that Japan has few concerns about, as a strategy for diversification. Therefore, Japanese businesses will now have to take full advantage of international cooperation frameworks such as the Free and Open Indo-Pacific (FOIP), the Indo-Pacific Economic Framework for Prosperity (IPEF) and the Quadrilateral Security Dialogue (QUAD) in order to achieve business matching.

Opacity and unpredictability would be extremely harmful in doing business. As Prof. Suzuki mentioned, there will be two types of goods in the coming days: goods for free trade and goods for managed trade. If the distinction between the two is not transparent, it will be harmful for business. So we need clear rules on this distinction. For example, the Economic Security Promotion Law adopted in Japan needs to designate specific crucial products in terms of economic security on the basis of rules and dialogue between the government and private business.

Furthermore, it will be necessary to apply international rules as widely as possible. The WTO would be the best venue for such rule-making, but it would be difficult. Rule-making could be achieved by utilizing a regional cooperation framework such as the IPEF, and I would like the Japanese government to take a leading role in this rule-making.

**Okada:** With many countries strengthening industrial policies, there will be large markets created in specific sectors in the US or European countries in particular, such as semiconductors, green-related areas and defense and space-related sectors. Though Japan is also working on creation of such markets by joint funding by the government and private business to develop new technologies, the US or European markets in these sectors are so huge that Japanese companies would also have to get a share of them. How do you think the Japanese government and businesses can work to resolve these issues?

**Todo:** Private companies must have an incentive to enter such huge markets in the US and Europe even without government help. There should not be any role played by the government in helping these companies. The only exception could be information provision by the government regarding the ambiguity of rules for those markets, if any. Subsidizing businesses designated by the government would not be a good solution. But the government could set up a dialogue with the private sector and get a good understanding of what private businesses would need and then release their message to the rest of the world.

## Responding to Rising Geopolitical Risks in the Long Term

**Okada:** Geopolitical risks are rising, as shown in the pandemic, the Ukraine crisis and the US-China confrontation. This increases uncertainty worldwide. It is therefore very important to learn about the future prospects of geopolitical risks and the government's economic security strategy. Japanese businesses will need to develop supply chain strategies to enhance the resilience of their supply chains to be prepared for unexpected changes in the business environment or rules, for example by diversifying production sites or material procurements or increasing stockpiles in a flexible manner, while the government will need to work on international rule-making appropriately to reduce these risks. Prof. Suzuki, what do you think about these challenges that the government and businesses must work on?

**Suzuki:** It is true that we cannot expect the continuation of the stable trading environment that we have benefitted from so far, given the continuing rise in geopolitical risks. In this situation, I think the Japanese government and businesses would be expected to promote structural reform continuously and gradually change our country's economy.

Even with the US-China conflict intensifying, sometimes ideologically and sometimes militarily, both nations' economic interdependency will not disappear and probably the economic interdependency between Japan and China would not disappear either. Even though China is considered hostile to the US and Japan, they cannot separate their economies from the Chinese economy. Under such circumstances, it is difficult to reduce risks to zero. Therefore, I think we should aim at surviving with these risks to a certain extent. It will be important to think about what is necessary for survival and prioritize what needs to be protected in the case of emergencies. For example, we should have a risk scenario taking the worst case into consideration to clarify what should be given up and what should be kept for survival in the case of an unexpected decline in sales or suspension of imports due to intensified confrontation between the US and China.

Without such a risk scenario and business continuity plan, it will be difficult to respond to an emergency quickly. We need to think about what to protect in our list of priorities among business operations and how much we would spend to protect them, in considering how to balance the size of the risk and the cost of raising resilience to reduce the risk. **JS**

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