

The era of geopolitical risk and the Japanese economy

Recommendation: Japan's approach to the era of geopolitical risk

How should Japan deal with the “era of geopolitical risk”? Below are recommendations classified into seven items including Japanese diplomacy, relations with other countries, and Japanese companies.

1. Japanese diplomacy — Japan must shape its own geopolitics

It is difficult to deal with the era of geopolitical risk without long-term government leadership. Formed in December 2012, the Shinzo Abe Cabinet is rare in Japanese politics as a long-serving administration. If this had been a continuation of the short-lived administrations that had marked Japanese politics for a time, Japan would have possibly suffered at the mercy of the turbulent international situation.

It just so happens that Prime Minister Abe is a politician with a strong geopolitical mind. In 2007 during the first Abe Cabinet, he gave a speech in the Indian parliament entitled “Confluence of the Two Seas”, and was highly praised for the speech. This idea is linked to his keynote speech at TICAD VI in Nairobi in 2016, in which he stated, “What will give stability and prosperity to the world is none other than the enormous liveliness brought forth through the union of two free and open oceans (Indian and Pacific) and two continents (Eurasia and Africa).” This describes a dynamic geopolitical stance characteristic of a seafaring nation like Japan.

The term “free and open Indo-Pacific” was also mentioned by President Trump during his address at the APEC summit in Da Nang, Vietnam, and is currently U.S. foreign policy terminology. It is also included in the early part of the regional strategy section of the Trump Administration's national security strategy announced in December 2017. The fact that an idea originating in Japan is used in U.S. foreign policy is quite groundbreaking in the history of Japan-U.S. relations.

In contrast, China advocates the “belt and road initiative”. Depending on how one views it, but it would seem that an emerging “land power” centering on China is challenging the status quo “sea power” of Japan, U.S. and other nations. However, viewing this in such a simplistic way will lead

to a dismal Bannon-like “dog-eat-dog” world view of economic nationalism which sees trade as a zero-sum game.

The critical part is the “free and open” before Indo-Pacific. Japan’s role is one of presenting the ocean concept of Indo-Pacific, and also selectively participating in the land concept of belt and road. Of course, this must be done based on global norms with full transparency and accountability so that it does not become a tool for extending Chinese interests or influence. In this sense, Japanese companies—the mainstay of economic activity—have a key role to play.

2. Relations with the U.S. — Japan must guide the Trump Administration in the right direction

The Japan-U.S. alliance is the cornerstone of Japanese diplomacy. As mentioned above, the fact that both Japan and the U.S. share a common Indo-Pacific strategy is indeed significant.

Especially considering the current situation on the Korean peninsula, it is crucial that Japan and the U.S. continue this close cooperation in security.

On the other hand, there is a growing risk that the trade war will gain momentum. The Trump Administration intends to (1) impose additional tariffs on steel and aluminium on the grounds of national security (Section 232 of the Trade Expansion Act), and (2) impose punitive tariffs against China’s intellectual property rights violations (Section 301 of the Trade Act). The Administration has also indicated (3) additional tariffs on automobile imports (Section 232 of the Trade Expansion Act). These developments are viewed as a form of grandstanding aimed at the upcoming midterm elections in autumn.

The Trump Administration in its first year was notable for its pro-business economic policies intrinsic to the Republican Party, such as passing large tax cuts and pushing ahead with deregulation. In its second year, though, it quickly took on a more economic nationalism character. A billionaire from New York, President Trump should have an affinity for globalism. But another side of Trump is the populist promoting economic nationalism, so he would seem to be moving back and forth between the two.

Prime Minister Abe has worked to build up a strong personal relationship with President Trump, and the two meet frequently for top-level discussions. It can be said that while other leaders are intimidated by Trump’s character and tend to be hesitant, Abe has waged a form of “contrarian diplomacy”. However, this does not mean that Abe is just mindlessly following Trump. He has been unwavering in asserting Japan’s view of “defending free trade”, including bringing together TPP11 after the U.S. pulled out.

The Trump Administration's bilateral focus on negotiations may deliver temporary results, but in the long run, it not only weakens the persuasiveness of U.S. assertions, but has the potential to demolish the liberal rules-based international order that has been built up to date. Japanese diplomacy should make every effort to encourage the U.S. to head in a desirable direction.

3. Relations with China — Japan must aim at selective participation in the belt and road initiative

The rapid rise of China has led to tensions in international relations and the global economy. There is some concern of a Thucydides Trap in which the two countries eventually clash over a Chinese challenge to U.S. supremacy. What makes this issue even more complex is that China faces persistent internal instability, and because of this, China tends to adopt an aggressive posture in its external dealings.

Historically, China is very adept at geopolitical maneuverings. The belt and road initiative put forward by China is to invest in sea and land route infrastructure in the Eurasian continent. In developing multiple beneficial bilateral relations by providing favors to neighboring countries, China aim in this is its own national interest so that it is not constrained in its actions by any other country. One example of this is that a port in Sri Lanka built with Chinese aid was handed over to a Chinese state-owned enterprise to repay the debt.

On the other hand, the belt and road initiative functions effectively as a global public good. The freight railway network linking east and west of the Eurasian continent known as the China Railway Express has been a boon to trade between the EU and China with steady progress being made since construction began in 2011. Some Japanese companies have begun considering shifting a part of their Europe-bound freight from sea to land transport. Active participation by Japanese companies in the constructive aspects of the belt and road initiative can be expected to deliver positive outcomes.

The “mutually beneficial relationship based on common strategic interests” within Japan-China relations means a win-win relationship in which “both sides cooperate where agreement can be reached, even though the goals may be different”. This is a significant change from the time when the sentimental slogan of “Japan-China Friendship” was held aloft. When taking part in the belt and road initiative, Japan must give primary thought to its own national interests.

4. Relations with North Korea — No need for wavering between optimism and despair

It goes without saying that currently Japan's major geopolitical risk is North Korea's development of nuclear weapons and ballistic missiles. Chairman Kim Jong-un set out on a

“peace offensive” following the 2018 PyeongChang Winter Olympics. South Korea’s President Moon Jae-in welcomed this, and the momentum for North-South unification quickly gained steam. On June 12, President Trump and Chairman Kim signed a historic joint statement at the U.S.-North Korea Summit in Singapore. If this continues, it would appear that there will be a major change in the Northeast Asia order, with only Japan left out of the loop.

It must be said, though, that the situation is still quite opaque. History tells us that we cannot expect a spirit of reciprocity based on goodwill from North Korea, but that they are acutely aware of the logic of power. Of course, denuclearization of North Korea and North-South reunification should be welcomed, but both processes will require a great deal of time.

Regarding the nuclear and missile threat, basically, the idea of deterrence is effective against North Korea. With a desire for their own survival and no wish to commit national suicide, the North Korean leadership would not attempt any military action without a clearly foreseeable outcome. This situation has continued over a number of decades, and the best strategy Japan can adopt is to hold fast to a strong Japan-U.S. alliance while continuing to steadily build up its defense capabilities. There is no easy solution to the risk posed by North Korea, so the focus should be on how to manage that risk.

5. Relations with Russia — Be patient and have no expectations on making a deal with the Putin Administration

How to deal with Russia is anything but easy. In view of the annexation of Crimea, interference in the U.S. presidential election, and the alleged attempted spy assassination in the U.K., Russia is clearly a revisionist power. On the other hand, considering its tradition of diplomatic pragmatism and limitations of its national power, Russia appears to have its eyes on becoming a status-quo power, but at the same time, seems to be taking the path to isolation with its failing communication with the West. It has already been more than four years since the West imposed economic sanctions on Russia, and there are no prospects of those sanctions being lifted.

Although imposing sanctions in line with other G7 member countries, Japan generally has its own mind when it comes to bilateral relations with Russia. Through a number of summits with President Putin, Prime Minister Abe is attempting to build up economic cooperation in Far East Russia and Eastern Siberia. With sights on long-term issues including resolving the northern territories issue and signing a peace treaty, Prime Minister Abe is perhaps also seeking to use Japan’s relations with Russia to apply some restraint on China and North Korea.

If a deal can be reached between Abe and Putin, it could be a major accomplishment for Japanese diplomacy. The Putin Administration's hardline foreign relations stance does, however, come with risk. Even though his current term of office continues until 2024, pursuing a relationship based on personal trust should be avoided. Relations with Russia should be approached with a spirit of patience but no expectations.

6. Global relations — Make the Osaka G20 Summit an opportunity for rebuilding globalism

In today's era of geopolitical risk, Japan has been afforded a wonderful opportunity. This is the G20 Summit to be held in Osaka in June 2019. This year marks ten years since the first G20 Summit held in Washington in November 2008 in the aftermath of the collapse of Lehman Brothers Holdings, and this, the 14th summit, will be the first time Japan serves as host nation. By the time the summit takes place on June 28–29, 2019, several areas of opacity in the current international situation should have been cleared up.

First, in the U.S. midterm elections in November this year, the American people will pass their judgment on the protectionist line of the Trump Administration, while in Europe, March 2019 is the deadline for Brexit negotiations. Also by that time, various issues in the Korean peninsula and in the Middle East will probably have become somewhat more stable.

Over this period, regular reciprocal visits by Japan's and China's leaders should have been revived. India is due to hold a general election in May next year, and it is very likely that the Modi administration will secure a second term. Two major free trade agreements reached in 2017—TPP-11 and the Japan-EU EPA—are planned to come into effect in spring 2019.

In Japan, the Osaka G20 Summit will be held at the beginning of a new Japanese era with a new era name to follow the current Heisei period. Each country should take this opportunity to shelve economic nationalism, and return to globalism. In 2019, there will be many diplomatic opportunities in which Japan will take center stage, including the enthronement ceremony and TICAD VII, and it is hoped that diplomatic efforts will forge ahead to put an end to the era of geopolitical risk. To this end, Japanese politics must be stable, and Japan must be viewed as being free from geopolitical risk.

7. Japanese companies — Latch on to a broad range of stakeholders

As Frank Knight stated, simply bemoaning “uncertainty” makes one unfit to be a company manager. And, of course, they can hardly look to the government to help them out. In an

environment lacking in clarity, there is a need for well-prepared company management that has put together as many options as possible.

For example, when there are concerns about not knowing the direction in which the U.S. government is headed, approaching stakeholders other than the federal government is one method that can be considered. Another method is for companies to hedge political risk by lobbying Congress, state governments, international agencies, or grassroots communities.

Uncertainty can be reduced by building multi-layered relationships with various stakeholders.

When the future is not clear, the fundamental response is to increase the number of options. The energy policy touched on in Chapter 6 is a typical example of this in which it is desirable to arrange as many energy sources as possible in preparation for future uncertainty. Company management should always be alert to broaden their arrangements for hedging risk.
