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Japan. Political Risk Report, December 2024

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EXECUTIVE SUMMARY

The purpose of this political risk report is to assess whether Japan is a suitable destination for investors. Through an analysis of its economic, political, geopolitical and industry, trade and energy landscapes, it establishes the risks posed to the stability of the country.

Regarding the **economic forecast**, the report finds that Japan will experience slow economic growth in the short and medium term. Real GDP growth is likely to grow by 1% annually from 2025 to 2029 while inflation is expected to remain at around 2% during the same period. Additionally, it is expected that Japan will effectively reduce its public debt from 251.2% GDP in 2024 to 245% GDP by 2029. Japan's future will be determined by its ability to expand production in high-tech and green industries, while combating imminent population decline and an aging workforce.

In relation to the **political outlook**, political instability is likely to persist in the short to medium term as the LDP-Komeito coalition lost its majority in the House of Representatives in the October elections, signaling prolonged legislative deadlock. The rise in support for the main opposition party, CDPJ, will pose significant challenges to the LDP's agenda moving forward as both the CDPJ and the LDP scramble to obtain outside-party support. With immigration in the political agenda, short term labor shortages are likely to continue to be addressed while long term solutions will be conditioned by the evolving political landscape.

Returning to a **trade** surplus in the medium term will depend on Japan's ability to engage with the ASEAN countries and foster its strategic partnerships in the region. As it pertains to **FDI**, inward FDI is likely to remain low due to Japan's systemic reluctance and aversion to external investment, while outward FDI is likely to increase, particularly in South and South-East Asia. Concerning **energy** prospects, as Japan plans to decarbonize its energy mix, nuclear and solar energy provide investment opportunities.

In terms of **geopolitical risk**, China remains Japan's main trading partner, while the US is its main ally. Balancing both relationships will determine the country's stability in the short to medium term. As regional tensions increase and security concerns mount, Japan is likely to bolster its defense industry and adopt a more assertive military stance, as evidenced by its goal to achieve military spending of 2% of GDP by 2027.

SWOT ANALYSIS

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> ● Business-friendly government policies. ● Highly-educated workforce and advanced technology. ● Strategic location. ● Friendly relations with both China and the US, the world's largest economies. ● Commitment to R&D. 	<ul style="list-style-type: none"> ● High public debt and slow economic growth. ● Limited natural resources, causing energy import dependence. ● Aging population. ● Strict immigration policies. ● Language and cultural barriers.
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> ● Development of green technologies and renewable energy. ● Expansion of free trade agreements. ● Semiconductor industry development. ● Depreciated yen. ● Japanese involvement and interconnectedness in South and South-East Asia. 	<ul style="list-style-type: none"> ● Political landscape instability. ● Economic dependence on China. ● Competition in manufacturing and technology from nearby countries. ● Historical susceptibility to external shocks. ● Geopolitical tensions in the Asia-Pacific region.

TIME FRAMES USED IN THIS REPORT

Short term: 1-2 years.
Medium term: 3-9 years.
Long term: 10-20 years.

1. ECONOMIC FORECAST

- Japan's Real GDP is expected to grow by 1.1% by 2025 and is forecasted to persist below 1% through 2029. Inflation will remain stable in the short term, decreasing to 2.1% in 2025 and in the medium term it is expected to continue at a steady 2% through 2029. While remaining significantly high, public debt is expected to decrease in the short term to 248.7% GDP by 2025 and in the medium term, it is expected to further decrease to 245% through 2029.
- Japan's industrial output is expected to stagnate in the short term and see moderate growth in the medium term driven by investments in high-tech industries such as semiconductors and digital technologies.
- Due to its persistently low fertility rate and high life expectancy, Japan has and will continue to experience significant demographic decline. With an average annual population decrease of 0.9%, projections indicate that the population will fall from 124.3 million in 2023 to about 106 million by 2044.

Macroeconomic Picture

In recent history, Japan's economy has been plagued by stagnation.¹ Throughout the 1990s Japan's Real GDP grew, on average, by 1% per year.² This slow economic growth carried on through the early 2000s and persisted despite Shinzo Abe's attempts to revitalize the economy during his second presidency in the 2010s.³ Today, Japan's economy is recovering from the aftermath of the Covid-19 pandemic, which saw Japanese Real GDP drop to its second lowest level in the last 40 years, falling short only to the 2009 global crisis.⁴ Despite the drastic economic impact of the pandemic, it is important to note that the decrease in Real GDP experienced by the Japanese economy was on par with advanced economies worldwide.⁵

¹ Callen, Tim and Ostry, Jonathan D. "Overview." in *Japan's Lost Decade: Policies for Economic Revival*, ed. Callen, Tim and Ostry, Jonathan D. (International Monetary Fund, 2003). <https://www.imf.org/external/pubs/nft/2003/japan/index.htm>.

² Ibid.

³ Yoshino, Naoyuki and Taghizadeh-Hesary, Farhad. "Three Arrows of "Abenomics" and the Structural Reform of Japan: Inflation Targeting Policy of the Central Bank, Fiscal Consolidation, and Growth Strategy." *Asian Development Bank Institute*, no. 492 (2014). Asian Development Bank.

⁴ IMF. "World Economic Outlook - Real GDP - Japan." October 2024. <https://www.imf.org/external/datamapper/profile/JPN>.

⁵ IMF. "World Economic Outlook - Real GDP." 2020. https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD/JPN.

Figure 1: Macroeconomic Indicators

<u>Indicators</u>	2023	2024	2025
Real GDP (% Growth)	1.7%	0.3%	1.1%
Budget Deficit (% GDP)	-4.2%	-6.1%	-3%
Public Debt (% GDP)	249.7%	251.2%	248.7%
Inflation Rate (% Growth)	3.3%	2.2%	2%
Unemployment Rate (%)	2.6%	2.5%	2.5%
Current Account Balance (% GDP)	3.6%	3.8%	3.6%

Author's elaboration from the IMF World Economic Outlook (October 2024).⁶

Real GDP

Japan's Real GDP is expected to grow by 0.3% in 2024, five times less than the growth experienced in 2023.⁷ Japan's Real GDP is projected to grow between 1% and 1.1% in 2025 according to the International Monetary Fund (IMF),⁸ the Organization for Economic Cooperation and Development (OECD)⁹ and the Bank of Japan (BOJ).¹⁰ Despite this low growth rate, Japan continues to trend in an upward trajectory following the negative Real GDP growth experienced in 2019 and 2020 as a result of the COVID-19 pandemic.¹¹ This slow growth rate, however, is forecasted to persist, remaining below 1% from 2026 to 2029.

The IMF estimates that the main factors limiting Japanese economic growth are its aging population paired with rigidity in the labor market.¹² These factors will continue to restrict Japanese economic output in the long term as labor shortages increase. Notwithstanding, Japan has seen slow, yet steady economic growth following its contraction during the Covid-19 pandemic.¹³ This growth is led by an increase in exports which greatly stimulated the economy

⁶ IMF. "Japan - Country Data." October 2024. <https://www.imf.org/external/datamapper/profile/JPN>.

⁷ IMF. "World Economic Outlook - Real GDP - Japan." October 2024. <https://www.imf.org/external/datamapper/profile/JPN>.

⁸ Ibid.

⁹ OECD. "Economic Outlook 115 - Real GDP Forecast - Japan." May 2024. <https://www.oecd.org/en/data/indicators/real-gdp-forecast.html?oecdcontrol-6d464da75a-var3=2025&oecdcontrol-6d464da75a-var5=A&oecdcontrol-1e26a1dec1-var1=JPN>.

¹⁰ Bank of Japan. "The BOJ's Forecasts for Real GDP: July 2024 Outlook." August 2024. https://www.boj.or.jp/en/about/press/koen_2024/data/ko240807a1.pdf.

¹¹ IMF. "World Economic Outlook - Real GDP - Japan." October 2024. <https://www.imf.org/external/datamapper/profile/JPN>.

¹² IMF Asia Pacific Department. "Japan: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Japan." International Monetary Fund. 2024. 4-5, eISBN: 9798400276644.

¹³ Ibid.

in the first half of 2023, surpassing pre-pandemic levels, and have persisted since.¹⁴ Domestic investment and consumption, however, are yet to recover to pre-pandemic levels.¹⁵

Additionally, in this year's *honebuto* paper on Basic Policy on Economic and Fiscal Management and Reform, the Japanese government has stated that it will target an annual growth of 1% Real GDP up to 2030.¹⁶ It seeks to achieve this goal by fostering the production of semiconductor chips and the development of artificial intelligence (AI).¹⁷ It will also focus investment efforts on attracting tourism in hopes of expanding the sector.¹⁸ Overall, Japanese economic and fiscal policy in the short term will be characterized by investment in tech and a focus on wage increases across sectors.¹⁹

Budget Deficit

Since 1993, Japan has been systematically at a budget deficit.²⁰ In 2024, Japan's budget deficit is expected to be -6.1% GDP²¹ and is projected to continue performing at a budget deficit in the short to medium term. In the short term, Japan's budget deficit is expected to decrease to -3% GDP by 2025 and in the medium term, it is expected to be at -4% GDP by 2029.²² In this year's *honebuto* paper, the government stated that it aims to achieve a budget surplus in 2025,²³ which appears to be highly unlikely. In recent history, Japan has not had a year's end positive budget surplus since 1992.²⁴ Continuous budget deficits have resulted in Japan's widening public debt, which remains one of its main areas of concern.

Public Debt

Japan has the second highest level of public debt (measured as a % of GDP), being surpassed only by Sudan.²⁵ In 2024, Japan's public debt as a percentage of GDP is projected to be 251.2%.²⁶ It is projected that this figure will decrease in the short and medium term, reaching

¹⁴ Trading Economics. "Japan GDP Growth Rate." October 2024. <https://tradingeconomics.com/japan/gdp-growth>.

¹⁵ IMF Asia Pacific Department. "Japan: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Japan." International Monetary Fund. 2024. 4-5, eISBN: 9798400276644.

¹⁶ Nagata, Kazuaki. "Japanese government restores 2025 primary budget surplus target." The Japan Times. June 21, 2024. <https://www.japantimes.co.jp/business/2024/06/21/economy/honebuto-fiscal-reconstruction/>.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Government of Japan Cabinet Office. "Basic Policy on Economic and Fiscal Management and Reform: 2024." June 21, 2024. https://www5.cao.go.jp/keizai-shimon/kaigi/cabinet/honebuto/2024/summary_en.pdf.

²⁰ IMF. "World Economic Outlook - General Government Net Lending/Borrowing - Japan." October 2024. https://www.imf.org/external/datamapper/GGXCNL_NGDP@WEO/JPN?zoom=JPN&highlight=JPN.

²¹ Ibid.

²² Ibid.

²³ Government of Japan Cabinet Office. "Basic Policy on Economic and Fiscal Management and Reform: 2024." June 21, 2024. https://www5.cao.go.jp/keizai-shimon/kaigi/cabinet/honebuto/2024/summary_en.pdf.

²⁴ IMF. "World Economic Outlook - General Government Net Lending/Borrowing - Japan." October 2024. https://www.imf.org/external/datamapper/GGXCNL_NGDP@WEO/JPN?zoom=JPN&highlight=JPN.

²⁵ O'Neill, Aaron. "The 20 countries with the highest public debt in 2023 in relation to the gross domestic product." Statista. September 19, 2024. <https://www.statista.com/statistics/268177/countries-with-the-highest-public-debt/>.

²⁶ IMF. "World Economic Outlook - General Government Gross Debt - Japan." October 2024. https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/JPN?zoom=JPN&highlight=JPN.

248.7% GDP by 2025, and 245% GDP by 2029.²⁷ Japanese public debt has been steadily growing since 1990 at an average rate of over 5.5% GDP per year.²⁸ During the Covid-19 pandemic, public debt grew from 236.4% GDP in 2019 to 258.4% GDP in 2020.²⁹ This drastic increase is greatly due to stimulus packages, subsidies and various fiscal measures implemented by the government in order to counteract the economic repercussions of the pandemic.³⁰ Despite this increase in government expenditure and high public debt, rating agencies perceive Japan as ‘stable’.³¹ In an effort to address its growing public debt, Japan is spending around 50% of its total tax revenue to service this debt.³² However, due to its aging population, Japan will soon incur various age related costs, limiting its potential for growth unless it makes drastic reforms.³³

Inflation Rate

Throughout the 2000s and 2010s, the Japanese economy experienced various periods of deflation.³⁴ In 2024, however, Japan is projected to reach a stable 2.2% inflation rate following Covid-19 related disturbances in consumer prices.³⁵ Inflation was cost driven immediately after the pandemic due to supply chain disruptions.³⁶ Years removed from the pandemic, inflation is now more demand driven, due to labor shortages.³⁷ It is projected that in the short to medium term, inflation will remain stable near 2% through 2029.³⁸

The Bank of Japan (BOJ) ended its negative interest rate policy (NIRP) in March, trusting that it can maintain a steady 2% annual inflation rate.³⁹ The NIRP had been set in place in order to boost economic growth and transition out of a deflationary tendency.⁴⁰ Predicting short term

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Cohen-Setton, Jérémie and Oikawa, Keita. “Japan’s public debt sustainability before and after COVID-19.” in *The Sustainability of Asia’s Debt: Problems, Policies and Practices*, ed. Benno Ferrarini, Marcelo M. Giugale et al., 66-86. Asian Development Bank. 2022. <https://www.elgaronline.com/edcollchap-0a/edcoll/9781800883710/9781800883710.00011.xml>.

³¹ Fitch Ratings. “Fitch Affirms Japan at ‘A’: Outlook Stable.” Rating Action Commentary. April 23, 2024.

<https://www.fitchratings.com/research/sovereigns/fitch-affirms-japan-at-a-outlook-stable-23-04-2024>.

³² O’Neill, Aaron. “The 20 countries with the highest public debt in 2023 in relation to the gross domestic product.” Statista. September 19, 2024. <https://www.statista.com/statistics/268177/countries-with-the-highest-public-debt/>.

³³ Fitch Ratings. “Japan Debt Trajectory at Risk as Possibility of Tightening Rises.” January 18, 2024.

<https://www.fitchratings.com/research/sovereigns/japan-debt-trajectory-at-risk-as-possibility-of-tightening-rises-18-01-2023>.

³⁴ IMF. “World Economic Outlook - Inflation Rate - Japan.” October 2024.

<https://www.imf.org/external/datamapper/PCPIEPCH@WEO/JPN?zoom=JPN&highlight=JPN>.

³⁵ Ibid.

³⁶ IMF Asia Pacific Department. “Japan: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Japan.” International Monetary Fund. 2024. 4-9. eISBN: 9798400276644.

³⁷ Ibid.

³⁸ IMF. “World Economic Outlook - Inflation Rate - Japan.” October 2024.

<https://www.imf.org/external/datamapper/PCPIEPCH@WEO/JPN?zoom=JPN&highlight=JPN>.

³⁹ IMF Asia Pacific Department. “Japan: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Japan.” International Monetary Fund. 2024. 4-9. eISBN: 9798400276644.

⁴⁰ Kihara, Leika. Komiya, Kantaro. “BOJ signals no rush in raising rates again, keeps policy steady.” Reuters. September 20, 2024.

<https://www.reuters.com/markets/asia/boj-keep-policy-steady-signal-more-rate-hikes-come-2024-09-19/#:~:text=The%20BOJ%20end%20negative%20interest.core%20inflation%20numbers%20for%20Japan>.

stability as a result of the wage increases achieved in this year's annual *Shunto*, and the subsequent increase in consumer spending, the BOJ has set interest rates at a steady 0.25% for the short term.⁴¹ In mid September, BOJ Governor Kazu Ueda stated that the 0.25% interest rate increase would not be modified, at least, until December 2024.⁴²

Unemployment Rate

Unemployment has remained stable at around 2.5% for the past three years and is projected to continue at this level in 2024 and 2025.⁴³ In the medium term, unemployment is forecasted to remain at a steady 2.5% through 2029.⁴⁴ While stable employment conditions persist, Japan continues to face labor shortages due to an aging population. In order to offset said shortages, policy measures were implemented in 2019 in order to facilitate immigration for blue-collar workers.⁴⁵ Said policies, however, have had limited effect on actual immigration due to their short temporal scope and lack of family unification permits.⁴⁶

Current Account Balance

For the past 41 years, Japan has been a “net lender”.⁴⁷ In 2024, the current account balance is projected to be at 3.8% GDP, with projections of this figure remaining at 3.6% GDP in the short term, decreasing to 3.1% GDP by 2029.⁴⁸ The current account balance surplus is driven by strong exports, particularly in the automotive industry, and an increase in inbound tourism.⁴⁹ Strong exports are being partially offset, however, by weak domestic demand.⁵⁰ In the following months, domestic consumption is expected to increase as a result of stable consumer prices and increased wages.⁵¹

⁴¹ Ibid.

⁴² Ibid.

⁴³ IMF. “World Economic Outlook - Unemployment rate - Japan.” October 2024.
<https://www.imf.org/external/datamapper/LUR@WEO/JPN?zoom=JPN&highlight=JPN>.

⁴⁴ Ibid.

⁴⁵ Lies, Elaine. “Japan considers widening long-term foreign worker visa scheme.” Reuters. April 24, 2023.
<https://www.reuters.com/markets/asia/japan-considering-expanding-fields-which-skilled-foreign-workers-can-receive-2023-04-24/>.

⁴⁶ Ibid.

⁴⁷ IMF. “World Economic Outlook - Current account balance, percent of GDP - Japan.” October 2024.
https://www.imf.org/external/datamapper/BCA_NGDPD@WEO/JPN?zoom=JPN&highlight=JPN.

⁴⁸ Ibid.

⁴⁹ IMF Asia Pacific Department. “Japan: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Japan.” International Monetary Fund. 2024. 8-11. eISBN: 9798400276644.

⁵⁰ Ibid.

⁵¹ Kihara, Leika. Komiya, Kantaro. “BOJ signals no rush in raising rates again, keeps policy steady.” Reuters. September 20, 2024.
<https://www.reuters.com/markets/asia/boj-keep-policy-steady-signal-more-rate-hikes-come-2024-09-19/#:~:text=The%20BOJ%20end%20negative%20interest.core%20inflation%20numbers%20for%20Japan>.

Overview of Major Economic Sectors

With only 11.2% of its land suitable for cultivation,⁵² Japan's agricultural sector remains small, contributing just 1% to GDP⁵³ and employing 3.1% of the workforce.⁵⁴ Rice, wheat and soybeans are the country's primary agricultural crops.⁵⁵ Nevertheless, Japan's dominant economic pillar is the services sector, accounting for 70% of GDP in 2023.⁵⁶ Leading this sector are the finance, insurance, and real estate sub-sectors, highlighting Japan's role as a major global financial hub. The services sector recorded a growth rate of 5.1% in 2023 and is forecasted to grow by 3.2% in 2024.⁵⁷

The industrial sector accounts for 29% of GDP⁵⁸ and employs 23.55% of the workforce.⁵⁹ During 2024, industrial output in Japan has fluctuated indecisively and is expected to continue to do so in the short term.⁶⁰ While there was a steady incline of industrial production in July, Japan's industrial production fell by -3.3% month-on-month in August.⁶¹ In September, industrial production grew for the first time in two months, rising by 1.4% month-on-month, primarily due to normalization of production in motor vehicles and related industries after a typhoon in late August disrupted operations.⁶² Japan's industrial production is expected to stagnate in the short term, primarily due to the ongoing recovery of its automotive industry from safety scandals involving companies such as Toyota, Mazda, Honda, and Suzuki.⁶³ Within the industry sector, in 2022 the manufacturing sub-sector accounted for 19.2% of the country's GDP, with wholesale and retail trade following behind at 14.3% of GDP.⁶⁴ The Japanese industrial sector is characterized by a blend of traditional and innovative industries. On the one hand, Japan has historically been renowned for its success in the automotive industry—it is the third-largest car manufacturer in the world—as well as in the electronics and machinery

⁵² World Bank. "Arable land (% of land area) - Japan." 2021. <https://data.worldbank.org/indicator/AG.LND.ARBL.ZS?locations=JP>.

⁵³ MarketLine. "Japan: In-Depth PESTLE Insights." May 2024. 52.

⁵⁴ O'Neill, Aaron. "Japan: Distribution of the workforce across economic sectors from 2012 to 2022." Statista. July 4, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/270161/economic-sector-distribution-of-the-workforce-in-japan/>.

⁵⁵ Fujibayashi, Keiko. "Japan Grain and Feed Annual." *USDA Foreign Agricultural Service*. March 20, 2024.

https://apps.fas.usda.gov/newgainapi/api/Report/DownloadReportByFileName?fileName=Grain%20and%20Feed%20Annual_Tokyo_Japan_JA2024-0014.pdf.

⁵⁶ MarketLine. "Japan: In-Depth PESTLE Insights." May 2024. 53.

⁵⁷ Ibid.

⁵⁸ MarketLine. "Japan: In-Depth PESTLE Insights." May 2024. 52.

⁵⁹ O'Neill, Aaron. "Japan: Distribution of the workforce across economic sectors from 2012 to 2022." Statista. July 4, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/270161/economic-sector-distribution-of-the-workforce-in-japan/>.

⁶⁰ Ministry of Economy, Trade and Industry. "Indices of Industrial Production." www.meti.go.jp. September 30, 2024.

https://www.meti.go.jp/english/statistics/tyo/iip/b2020_202408se.html.

⁶¹ Ibid.

⁶² Ministry of Economy, Trade and Industry. "Indices of Industrial Production." www.meti.go.jp. October 31, 2024.

<https://www.meti.go.jp/english/statistics/tyo/iip/index.html>.

⁶³ Kang, Min Joo. "Japan: Auto sector hampers overall industrial production in June." ING. July 31, 2024. <https://think.ing.com/snaps/japan-auto-sector-hampers-overall-industrial-production-in-june/>.

⁶⁴ Statista Research Department. "Share of contribution to the gross domestic product (GDP) at current prices in Japan in 2022, by industry." Statista. January 12, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/1244173/japan-share-nominal-gdp-by-industry/>.

sectors.⁶⁵ On the other hand, the country is recently focusing on emerging sectors such as robotics, semiconductors, and high-tech materials to maintain its position as a global industrial leader.

In the medium term, Japanese industrial production will experience structural changes, driven by demographic and global economic shifts. A declining population will reduce domestic demand, exerting downward pressure on industrial production. Simultaneously, key export sectors, particularly manufacturing and electronics, may see slower growth due to increased competition from neighboring countries and global market fluctuations. However, Japan's focus on high-tech industries, including semiconductors and advanced digital technologies, will likely help mitigate some of these challenges. Additionally, recovery of the silicon cycle will contribute to Japan's growth in production of semiconductor-related goods.⁶⁶ As advances in digitalization and decarbonization cause disruptive changes across various industries, Japan's industrial strategy is well placed to mitigate these risks.⁶⁷

Japan's Position in Microchip Manufacturing

Japan's once-leading chip manufacturing sector has declined over the past three decades due to its failure to move away from vertical integration, which prioritized in-house production, to a fabless business model.⁶⁸ Additionally, South Korea, Taiwan, and China have emerged as dominant players in the semiconductor business, further undermining Japan's market share. Today, Japan accounts for approximately one-tenth of global semiconductor sales.⁶⁹

Recognizing the strategic importance of semiconductors for economic security, the Japanese government has unveiled an ambitious plan to revitalize the domestic semiconductor industry.⁷⁰ Japan inaugurated its semiconductor industry revitalization strategy with an investment of 3.9 trillion yen (\$24.8 billion) in the sector between 2021 and 2023—about 0.7% of GDP,⁷¹ a significantly higher share than the investments made by the US, Germany, and France during

⁶⁵ Statista Research Department. "Motor vehicle production volume worldwide in 2023, by country." Statista. March 28, 2024. <https://www.statista.com/statistics/584968/leading-car-manufacturing-countries-worldwide/>.

⁶⁶ Ishikawa, Kiyoka. "July 2024 Industrial Production." Daiwa Institute of Research. August 30, 2024. https://www.dir.co.jp/english/research/report/jsothers/20240902_024589.pdf.

⁶⁷ Japan External Trade Organization. "Digitalization and decarbonization will be the driving trends of Japan's manufacturing industry." 2024. https://www.jetro.go.jp/en/invest/attractive_sectors/manufacturing/overview.html.

⁶⁸ Tomoshige, Hideki. "Japan's Semiconductor Industrial Policy from the 1970s to Today." *Center for Strategic and International Studies*. September 19, 2022. <https://www.csis.org/blogs/perspectives-innovation/japans-semiconductor-industrial-policy-1970s-today>.

⁶⁹ Alsop, Thomas. "Semiconductor market revenue share based on company headquarters worldwide from 2018 to 2022, by region." Statista. October 18, 2023. <https://www-statista-com.ezproxy.unav.es/statistics/510374/worldwide-semiconductor-market-share-by-country>.

⁷⁰ Ministry of Economy, Trade and Industry. "Strategy for Semiconductors and the Digital Industry." June 4, 2021. https://www.meti.go.jp/english/press/2021/0604_005.html.

⁷¹ Nippon. "Japan Making Major Investments in its Semiconductor Industry." April 22, 2024. <https://www.nippon.com/en/japan-data/h01965/>.

the same period.⁷² Despite this commitment, the Japanese semiconductor market shrank by 16.3% in 2023 to reach a value of \$39.7 billion,⁷³ largely due to supply chain constraints and global shortages. However, projections suggest the market will rebound to reach a value of \$49.3 billion in 2028, an increase of 24.4% from 2023.⁷⁴

To solidify its position in strategic manufacturing and technology, Japan is pursuing a ‘two track strategy’ of attracting foreign companies and fostering the growth of domestic companies. A reflection of this strategy is the network of alliances Japan has formed to strengthen the resilience of the global semiconductor supply chain. As part of this effort, Taiwan Semiconductor Manufacturing Company Limited (TSMC) has made a significant investment in Japan with the establishment of Japan Advanced Semiconductor Manufacturing (JASM) in Kumamoto, a \$20 billion project supported by the Japanese government.⁷⁵ JASM will feature two fabrication plants (fabs) producing over 100,000 12-inch wafers per month using advanced process technologies, while creating over 3,400 high-tech jobs and implementing green manufacturing practices.⁷⁶ Another flagship initiative in Japan’s semiconductor revival strategy is Rapidus, a government-backed microchip startup with a consortium of Japanese companies in collaboration with IBM and the European research organization IMEC.⁷⁷ Rapidus aims to mass produce two nanometre logic chips by 2027,⁷⁸ a move that could elevate Japan’s competitive standing in advanced technologies such as AI, 5G, and quantum computing. This initiative aligns with the government’s broader goal of tripling domestic semiconductor-related sales to 15 trillion yen (approximately \$99.4 billion) by 2030.⁷⁹ However, achieving its ambitious goals will require Japan to address workforce shortages, foster innovation, and ensure sustained investment.

As the global semiconductor industry is projected to become a trillion-dollar industry by 2030,⁸⁰ Japan’s strategic investments and partnerships could position it to capture a larger share of this

⁷² Huang, Grace. “Why Japan May Be the Next Semiconductor Powerhouse.” AGF Management Limited. August 8, 2024. <https://perspectives.agf.com/why-japan-may-be-the-next-semiconductor-powerhouse/#:~:text=According%20to%20a%20report%20released.%25>

⁷³ MarketLine. “Semiconductors in Japan.” January 2024. <https://advantage-marketline-com.ezproxy.unav.es/Analysis/ViewasPDF/japan-semiconductors-ml-215430>.

⁷⁴ Ibid.

⁷⁵ TSMC. “TSMC Celebrates the Opening of JASM in Kumamoto, Japan.” February 24, 2024. <https://pr.tsmc.com/english/news/3113>.

⁷⁶ Ibid.

⁷⁷ Government of Japan. “Japan’s Pursuit of a Game-Changing Technology and Ecosystem for Semiconductors.” March 1, 2024. https://www.japan.go.jp/kizuna/2024/03/technology_for_semiconductors.html#:~:text=Japan%20occupied%20more%20than%20half%20of%20the%20global,produced%20in%20Japan%20now%20is%20the%2040-nm%20chip.

⁷⁸ Ibid.

⁷⁹ Japan External Trade Organization. “Japan’s Rapidus Helping to Create a Global Tech Incubator.” September 2023. <https://www.jetro.go.jp/en/invest/insights/japan-insight/rapidus-helping-create-global-tech-incubator.html#:~:text=Under%20the%2520%25E2%2580%259CSemiconductor%2520and%2520Digital,15%20trillion%2520yen%2520by%25202030>.

⁸⁰ Burkacky, Ondrej. Dragon, Julia. et al. “The semiconductor decade: A trillion-dollar industry.” McKinsey & Company. April 1, 2022. <https://www.mckinsey.com/industries/semiconductors/our-insights/the-semiconductor-decade-a-trillion-dollar-industry>.

rapidly growing market. Japanese companies hold a 56% share of the global market for semiconductor materials and 32% for semiconductor production equipment,⁸¹ providing a valuable foundation for Japan to leverage its strengths in high-quality manufacturing.

Demography and Labor Force Dynamics

Japan has seen and will continue experiencing significant demographic transformations throughout this century. Since the postwar era, Japan experienced continuous population growth, reaching its highest point in 2010 with 128 million inhabitants. However, the Japanese population has since entered a phase of decline.⁸² In 2023, Japan's total population was 124.3 million.⁸³ Projections indicate that this number will further decline, potentially reaching 87 million by 2070, with an average annual population decrease of 0.9%.⁸⁴ If this trend persists, in 20 years, by 2044, the total population is projected to fall to about 106 million.

Japan faces significant demographic challenges due to its persistently low fertility rate, which dropped to a record low of 1.2 per woman in 2023.⁸⁵ The declining fertility rate not only signals a shrinking labor force but also raises concerns about Japan's ability to sustain economic growth and productivity in the future. At the same time, Japan's elderly population has been consistently increasing, reaching 28.9% of the population in 2021—the highest proportion of seniors globally.⁸⁶ This figure is projected to rise to approximately 38.4% by 2065.⁸⁷ If this growth continues linearly, it can be projected that in 20 years, by 2044, the ratio will reach around 33.9%, highlighting the ongoing demographic shift. This is expected to strain the labor force and social insurance systems, with the elderly placing increasing demands on healthcare and pension systems.

The percentage of the population eligible to work, defined as those aged 15 to 64, reached a peak of nearly 70% between 1991 and 1993.⁸⁸ Since that peak, this percentage has rapidly declined to just over 59%, representing the lowest level among the Group of Seven (G7)

⁸¹ Musha, Ryoji. "Japanese Stocks Outstandingly High, U.S.-China Confrontation and Super Weak Yen Turned the Tide." Musha Research. June 5, 2023. [https://www.musha.co.jp/attachment/647d5ae7-4e50-47cf-9dc2-0195ac1a01f4/Musha%2520Research%2520Commentary%2520\(Strategy%2520Bulletin%2520Vol%2520333\)_2023.06.05.pdf](https://www.musha.co.jp/attachment/647d5ae7-4e50-47cf-9dc2-0195ac1a01f4/Musha%2520Research%2520Commentary%2520(Strategy%2520Bulletin%2520Vol%2520333)_2023.06.05.pdf).

⁸² Solis, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 70-72.

⁸³ Trading Economics. "Japan Population." October 11, 2024. <https://tradingeconomics.com/japan/population>.

⁸⁴ Saito, Jun. "New Population Projection: How does it differ from the old one?." Japan Center for Economic Research. May 15, 2023. <https://www.jcer.or.jp/english/new-population-projection-how-does-it-differ-from-the-old-one>.

⁸⁵ Koyama, Aiju, Ozaki, Akihiko, et al. "Tackling Japan's population crisis by improving the childcare environment." *The Lancet* 404, no. 10450 (2024): 333-334. [https://doi.org/10.1016/S0140-6736\(24\)01175-9](https://doi.org/10.1016/S0140-6736(24)01175-9).

⁸⁶ Inoue, Takashi, Inoue, Nozomu. "The Future Process of Japan's Population Aging: A Cluster Analysis Using Small Area Population Projection Data." *Population Research and Policy Review* 43, no. 4 (2024): 58. <https://doi.org/10.1007/s11113-024-09903-5>.

⁸⁷ Ibid.

⁸⁸ Hong, Gee Hee, Schneider, Todd. "Shrinkonomics: Lessons from Japan." *Finance and Development Magazine* 57, no. 1 (2020): 21. <https://www.imf.org/external/pubs/ft/fandd/2020/03/pdf/fd0320.pdf>.

countries.⁸⁹ The decline in the number of individuals entering the labor force has precipitated shortages of workers, most notably in the manufacturing sector.⁹⁰ This poses challenges for maintaining productivity levels and meeting market demands.

In 2018, Japan's healthcare spending amounted to 10.9% of GDP, with the IMF projecting this to increase to 12.1% by 2030.⁹¹ Among OECD countries, Japan has the highest ratio of elderly individuals to those of working age. The old-age dependency ratio increased significantly, from about 10% in 1990 to nearly 30% by 2023.⁹² By 2060, it is expected that for every working-age individual, there will be nearly one elderly dependent.⁹³ Given this trend, Japan's dependency ratio is expected to keep increasing in the next decade, significantly exceeding 2023 levels. As a result, Japan's welfare systems will experience greater strain.⁹⁴

While boosting fertility and employment rates could alleviate Japan's demographic issues, prioritizing productivity enhancement is essential for tackling these challenges. The complexities involved in increasing fertility rates – shaped by shifting social norms and the long delay before realizing any demographic benefits – necessitate that Japan prepares for a future marked by low fertility levels.⁹⁵ Looking ahead to 2044, it will be important to focus on improving labor force participation. If Japan fails to adopt comprehensive policies designed to reverse the decline in fertility and eliminate barriers that restrict employment opportunities for women and older adults, it will continue to struggle with labor shortages in the long term. Furthermore, embracing a greater influx of foreign workers could serve as an immediate remedy to workforce gaps.

Scenario Construction I: Future of Japanese Demographics

Research question: In the next 10-20 years, how will demographics evolve?

As an initial consideration, the evolution of Japanese demographics will be dictated by how the government addresses current and plausible drivers that influence demographic policy. The

⁸⁹ Scoot, Andrew. "The Long, Good Life." *Finance and Development Magazine* 57, no. 1 (2020): 12. <https://www.imf.org/external/pubs/ft/fandd/2020/03/pdf/fd0320.pdf>.

⁹⁰ D'Ambrogio, Enrico. "Japan's ageing society." *European Parliament*. December 15, 2020. [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/659419/EPRS_BRI\(2020\)659419_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/659419/EPRS_BRI(2020)659419_EN.pdf).

⁹¹ Ibid.

⁹² Mitsuru, Katagiri, Takemasa, Oda, et al., "Demographic Trends and Household Savings and Investment." Bank of Japan. July 26, 2024. https://www.boj.or.jp/en/research/wps_rev/lab/lab24e01.htm.

⁹³ Ibid.

⁹⁴ Ibid.

⁹⁵ Jones, Randall S. "Addressing demographic headwinds in Japan: A long-term perspective." *OECD Economics Department Working Papers*, No. 1792 (2024): 13. <https://doi.org/10.1787/96648955-en>.

impact of the drivers is thought on the assumption that regardless of which political party is in power, demographic trends will be a central issue for the next 10-20 years.

Figure 2: Possible scenarios on the evolution of Japan’s demographic policies (long term)

DRIVERS	POSSIBLE SCENARIOS		
	Attempted reforms lead to limited improvement of the decographic decline	Reforms successfully alleviate demographic decline	Government inaction leads to continued demographic decline
Work culture	++	-	+
Technological innovation in automation	+	++	-
Japan’s public debt	++	-	+
Aging population and increased demand for healthcare	++	+	-
Support for families (tax breaks, child support, etc.)	+	++	-
Cultural resistance to immigration	+	-	++
Increase in retirement age	+	++	-

Legend:

- ++ ⇒ very positive impact on the plausibility of the scenario
- + ⇒ positive impact on the plausibility of the scenario
- ⇒ negative impact on the plausibility of the scenario
- ⇒ very negative impact on the plausibility of the scenario

Scenario 1: Attempted reforms lead to limited improvement of the demographic decline (*most likely*)

Among the possible outcomes, this scenario is the most likely due to Japan's acknowledgement of its demographic challenges, yet the scale and complexity of the reforms required to successfully deal with such challenges remain overwhelming for the government. For instance, while the 2023 "Direction on Strategy for Children's Future", which offers increased financial assistance for young families, and other reforms like expanded childcare services and improved parental leave policies represent significant steps forward, Japan is still struggling to reverse its low fertility rate.⁹⁶

Due to challenges rooted in Japanese cultural norms and financial constraints, the reforms Japan is implementing are unlikely to fully reverse its demographic decline. Many of these initiatives fall short in addressing the specific economic burdens that families face today. For example, the impact of these changes is limited by the elevated costs of living and the intense demands of Japan's work culture. In this scenario, immigration policy is also an issue of contention. Despite rising immigration, foreign-born residents account for only 2.3% of Japan's population, a figure that remains insufficient to address the country's labor shortages.⁹⁷

Therefore, Japan is probably going to keep trying to solve its demographic problems through reforms, but the difficulty of these initiatives points to their limited success. These reforms may not succeed because of enduring cultural and economic constraints. Japan thus finds itself in a position to implement additional failed reforms, which will make it more challenging to reverse its demographic decline and deal with its long-term population problems.

Scenario 2: Japan implements successful reforms to address demographic decline (*moderately unlikely*)

In the long term, it is moderately unlikely that Japan will successfully implement a strategy to address population decline. Currently, Japan is acknowledging the severity of its demographic crisis and has introduced different initiatives aimed at reversing the declining birth rate and mitigating the effects of an aging population.

⁹⁶ Shujiro, Urata. "Combating depopulation in Japan." East Asia Forum. March 5, 2024. <https://eastasiaforum.org/2024/03/05/combating-depopulation-in-japan/>.

⁹⁷ OECD. "OECD Economic Surveys: Japan 2024." January 11, 2024. <https://doi.org/10.1787/41e807f9-en>.

A key factor that supports this scenario is the government's commitment to allocate significant funding to family support initiatives, such as child allowances, economic assistance for child delivery and education.⁹⁸ A reflection of this is the 3 trillion yen (\$20 billion) annual investment proposed under the Direction on Strategy for Children's Future.⁹⁹

However, this scenario is likely to be met with challenges that could undermine its success. Japan's public debt remains a limiting factor, making it difficult to sustain large-scale investments in family programs. Moreover, societal resistance to large-scale immigration slows the influx of skilled foreign workers, a key factor that could help mitigate the economic effects of an aging population.¹⁰⁰

Thus, while Japan has initiated various strategies aimed at addressing its demographic decline, the likelihood of successfully implementing these reforms and reversing the trend remains moderately low. The government's commitment to significant funding signals a positive step forward. However, persistent challenges threaten to undermine these efforts.

Scenario 3: Japan's government inaction leads to continued demographic decline (*highly unlikely*)

This scenario, in which Japan fails to address its demographic challenges and stagnates, is highly unlikely given the current pressures on the government to take action.

There are potential reasons why the Japanese government could fall into inaction. One key factor is economic constraints. Japan's national debt limits the government's ability to fund large-scale reforms or long-term welfare programs.¹⁰¹ This could result in the government prioritizing short-term economic stability over more long-term policies that address demographic decline. Cultural resistance also plays a role. Societal norms around work culture make it difficult to implement reforms. If corporate culture continues to demand long working hours, young people may continue to delay having children, leading to further population decline. Lastly, a lack of political will to confront sensitive issues like immigration could also lead to stagnation.¹⁰²

⁹⁸ Shujiro, Urata. "Combating depopulation in Japan." East Asia Forum. March 5, 2024. <https://eastasiaforum.org/2024/03/05/combating-depopulation-in-japan/>.

⁹⁹ Ibid.

¹⁰⁰ OECD. "OECD Economic Surveys: Japan 2024." January 11, 2024. <https://doi.org/10.1787/41e807f9-en>.

¹⁰¹ Ibid.

¹⁰² Solís, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 69-76.

Despite these reasons for government inaction, it is highly unlikely due to the political and economic pressure to address the significant demographic crisis. The risks associated with continued population decline cannot be ignored by the government, making inaction unlikely.

Given the magnitude of the demographic decline caused by low fertility rates, it is highly likely that Japan will address this issue through policies and economic incentives in years to come. However, it is important to note that the result of said policies will be difficult to measure due to their long-term nature and interdependence with other policies.

2. POLITICAL OUTLOOK

- Following the elections held on October 27th, 2024, the Liberal Democratic Party (LDP) - Komeito coalition has lost its majority in the House of Representatives creating uncertainty in regards to the formation of a majority cabinet. The Constitutional Democratic Party (CDPJ) now poses a significant threat to the LDP as it holds 31.8% of House of Representative seats.
- It is expected that Ishiba will remain in power through a minority cabinet and policy matters in the House of Representatives will possibly reach a deadlock, as neither the LDP nor CDPJ can reach the 233 majority threshold without compromise.
- Over the next decade, Japan's foreign resident population is projected to increase to 4.39 million, or 3.5% of the population. However, this growth will likely fall short of meeting the labor demands driven by an aging population and low birth rates. Without a shift from short-term labor programs to long-term residency and integration policies, Japan's labor shortages are expected to intensify.

Political Landscape

Party Analysis

The House of Representatives (Lower House of the Diet) is the most important branch of power in Japan.¹⁰³ The House of Representatives has the power to pass legislation, appoint the Prime Minister (PM), pass treaties and establish the budget.¹⁰⁴ Even in the absence of approval of legislative efforts from the Upper House of the Diet, the House of Representatives has the power to pass legislation with a two-thirds majority.¹⁰⁵

Since its establishment through the merger of the Liberal Party and the Democratic Party in 1955, the LDP has been Japan's ruling party almost continuously, contributing to the country's political stability.¹⁰⁶ The LDP has controlled the House of Representatives and therefore, the

¹⁰³ Asia for Educators. "Government and Politics in Modern Japan." Accessed on October 30, 2024. Weatherhead East Asian Institute Columbia University. https://afe.asia.columbia.edu/special/japan_1950_politics.htm.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Hamzawi, Jordan. "Old Party, New Tricks: Candidates, Parties, and LDP Dominance in Japan." *Japanese Journal of Political Science* 23, no. 3 (2022): 283–93. <https://doi-org.ezproxy.unav.es/10.1017/S1468109922000172>.

cabinet for over 50 out of the last 60 years.¹⁰⁷ The LDP is a center-right conservative political party that endorses increased defensive capabilities and defensive autonomy as it pertains to security matters. Economically, the LDP has pushed for increased wages and further development of tech sectors. The LDP has been able to remain in power greatly due to their coalition with *Komeito*, a centrist conservative party whose roots derive from the Buddhist movement *Soka Gakkai*.¹⁰⁸

In recent years, however, the LDP has been plagued by controversy and instability from within. In the past month of September, PM Fumio Kishida decided to step down from his role after enduring months of public scrutiny due to LDP political corruption scandals and rising living costs.¹⁰⁹ Public discontent towards the LDP had been brewing behind the scenes. Scandals related to their ties to the Unification Church and the subsequent unreported funding of factions within the LDP has ultimately led to the dissolution of all but one LDP faction and loud public outcry.¹¹⁰ These scandals were the root cause behind Fumio Kishida's decision to step down from his role as PM in September, 2024 and why current PM Shigeru Ishiba called for elections to take place on October 27th, 2024 rather than in November 2025, as was previously expected.

The results of these elections, which introduce a degree of uncertainty, have brought about significant change to Japan's political landscape. As represented in Figure 5, the LDP and Komeito lost their coalition majority, leaving a power vacuum within the House of Representatives which may see a new coalition rise as the LDP and the CDPJ scramble to obtain cross-party support.

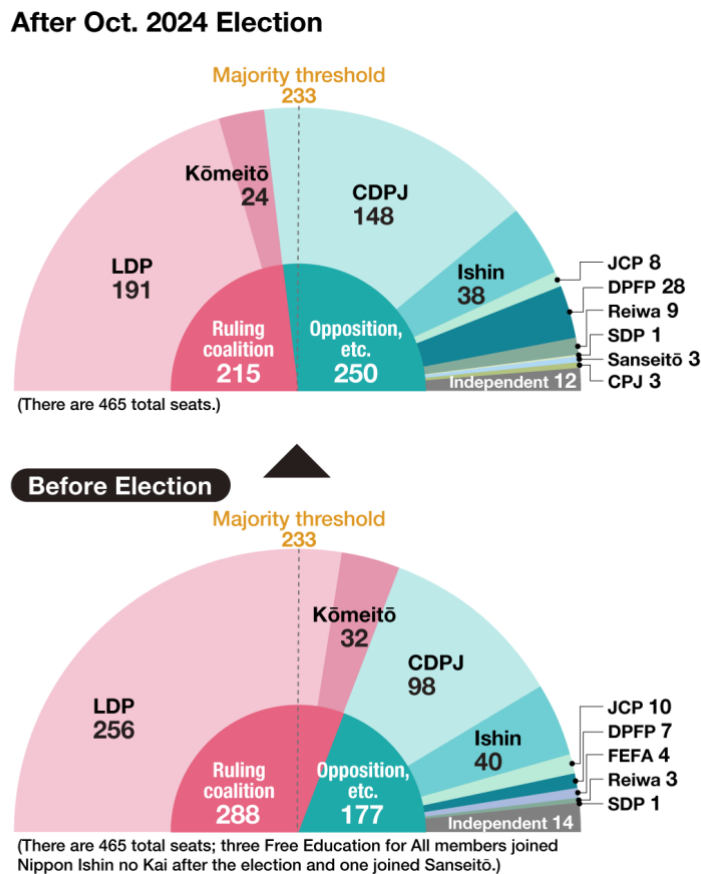
¹⁰⁷ Asia for Educators. "Government and Politics in Modern Japan." Accessed on October 30, 2024. Weatherhead East Asian Institute Columbia University. https://afe.easia.columbia.edu/special/japan_1950_politics.htm.

¹⁰⁸ Klein, Axel. McLaughlin, Levi. "Kōmeitō: The Party and Its Place in Japanese Politics." in *The Oxford Handbook of Japanese Politics*, edited by Robert J. Pekkanen, and Saadia M. Pekkanen, 201–222. Oxford Academic, 2020. <https://doi.org/10.1093/oxfordhb/9780190050993.013.5>.

¹⁰⁹ Kelly, Tim. Murakami, Sakura. "Japan's Prime Minister Kishida to resign, paving way for new leader." Reuters. August 14, 2024. <https://www.reuters.com/world/japan/japan-pm-kishida-wont-run-re-election-ldp-race-kyodo-reports-2024-08-14/>.

¹¹⁰ Khalil, Shaimaa. "Japan's scandal-hit ruling party picks next PM." BBC News. September 27, 2024. <https://www.bbc.com/news/articles/cv89ez894rko>.

Figure 3: House of Representatives Seats Evolution



Data Source: www.Nippon.com¹¹¹

Opposition Parties

As depicted in Figure 5, the parties which gained the most from these past elections were the LDP’s largest opposition party, the CDPJ, with a gain of 50 seats in the House of Representatives, and the Democratic Party For the People (DPFP), with a gain of 21 seats. Additionally, the Ishin no Kai party (Ishin) will be of great relevance in the formation of the next government as either side, the LDP or the CDPJ would benefit from a coalition with it, as it still holds the third most seats in the House of Representatives.

The CDPJ is the LDP’s main opposition led by Yoshihiko Noda. The CDPJ is a center-left political party whose policies consist of a strict interpretation of the constitution and pacifism

¹¹¹ Nippon. “Ishiba’s LDP coalition Loses Majority in Japan Election: Political Uncertainty Ahead.” October 28, 2024. <https://www.nippon.com/en/japan-data/h02176/>.

with a focus on human rights.¹¹² Economically, it pushes for an open market economy with special consideration for the well-being of the individual. It also pushes for a sustainable corporate structure, encouraging workers to avoid the “excessive self-responsibility”¹¹³ which currently exists in the corporate landscape. The results of these past elections served as indication that the Japanese public want change. The CDPJ saw its seats in the House of Representatives grow from 98 to 148, knocking the LDP-Komeito coalition out of power and positioning itself as a contender if able to form a coalition. Currently, the CDPJ is meeting with leaders from Ishin and the DPFP as it seeks to reach common ground on basic policies and discuss the possibility of nominating Noda for PM.¹¹⁴

The DPFP is a conservative centrist party which emerged in 2017 and survived its majority merger with the CDPJ in 2020.¹¹⁵ Led by Yuichiro Tamaki, the party’s current priority is the implementation of economic policies that effectively increase real wages.¹¹⁶ Its recent electoral success is greatly attributed to its ability to gain youth engagement through its focus on policy rather than political confrontation.¹¹⁷ Moving forward, the DPFP is burdened with more political weight than ever before. Along with Ishin, the DPFP will yield great political power as it now holds the fourth most seats in the House of Representatives and will therefore hold real decision making power on policy matters.

Ishin, or the Japan Innovation Party, is a reformist party led by Nobuyuki Baba.¹¹⁸ Socially, it believes that drastic structural reforms are necessary as it seeks to establish free education for all and promote equal opportunity and diversity. Politically, it seeks to decentralize the government away from Tokyo and reduce bureaucracy by reducing staff, salaries and external political incentives. In matters of defense, it believes that establishing adequate defensive and deterrence capabilities is imperative given the rising threat that China, North Korea and Russia pose in the region.¹¹⁹ Despite being the party with the third most seats in the House of Representatives, Ishin has faced criticism from its supporters as it lost two seats in these past October elections. As of October 31st, 2024, evidence suggests that Ishin is set to hold internal

¹¹² The Constitutional Party of Japan. “Basic Policies.” CDP Japan. Accessed on November 1, 2024. <https://cdp-japan.jp/english/basic-policies/>.

¹¹³ Ibid.

¹¹⁴ The Yomiuri Shimbun. “Japan Opposition Party CDPJ Aims to Join Forces With Others; Some Reluctant Over Differences in Basic Policies.” October 31, 2024. <https://japannews.yomiuri.co.jp/politics/politics-government/20241031-219854/>.

¹¹⁵ Pekkanen, Robert J. Reed, Steven R. Smith, Daniel M. “Japan Decides 2021: The Japanese General Election.” November 30, 2022. 66-67. https://books.google.es/books?id=zQafEAAAQBAJ&pg=PA66&redir_esc=y#v=onepage&q&f=false.

¹¹⁶ Nippon. “DPFP to seek income, gasoline tax cuts: Tamaki.” October 29, 2024. <https://www.nippon.com/en/news/yjj2024102900626/>.

¹¹⁷ Ninivaggi, Gabriele. “How Japan’s new kingmaker party won over young voters.” The Japan Times. November 1, 2024.

<https://www.japantimes.co.jp/news/2024/11/01/japan/politics/ninivaggi/politics-youth-vote-dpp/>.

¹¹⁸ Ishin. “About Us.” Accessed on October 30, 2024. <https://o-ishin.jp/en/>.

¹¹⁹ Ishin. “5. Threats to Japan’s Security.” Accessed on October 30, 2024. https://o-ishin.jp/en/basic_information/basic_policies/.

elections to decide a new direction for its leadership.¹²⁰ Ishin will play a crucial role in the short term as its alliance with either the CDPJ or the LDP could be a determining factor in naming the next PM. Currently, Ishin and the CDPJ have not reached an agreement, however, talks continue between both parties as they seek to avoid another LDP-Komeito administration.¹²¹

Finally, despite not carrying significant political weight, it is important to note the recent rise in popularity of the extremist right wing parties Sanseitō and the Conservative Party of Japan (CPJ). Sanseitō, now holding three seats in the House of Representatives, has had an explosive rise in popularity as it became popular on YouTube during the COVID-19 pandemic for spreading anti-vaccine rhetoric and referring to the vaccine as a “murder weapon”.¹²² It seeks to reform the education system and its policies are highly nationalistic and anti-immigration.¹²³ Similarly, the CPJ, which is also a conservative right-wing nationalist party, has gained three seats in the House of Representatives.¹²⁴ While holding no significant political power, the rise in popularity of these highly nationalistic right-wing parties shows that the Japanese public is tired of the single party rule which has persisted in the greater part of the last century as it now calls for change.

Post-Electoral Landscape

The new political instability in Japan is likely to persist in the short to medium term, as the ruling LDP’s weakened position and reliance on selective alliances suggest ongoing legislative gridlock and uncertain coalition dynamics. The October 27th election left Japan’s political landscape in an unprecedented state of flux, with the opposition gaining substantial ground and the ruling LDP–Komeito coalition suffering far greater losses than anticipated. Though a reduction in seats was expected, the scale of the setback—especially for the LDP, which dropped from 256 to 191 seats—signals a significant shift in public sentiment. Losing its parliamentary majority for the first time since 2009, the LDP-Komeito coalition now stands 18 seats short of the 233 required for a majority in the 465-seat House of Representatives. Although opposition parties gained momentum, their fractured structure suggests they lack a clear path to forming an alternative government.

¹²⁰ Nippon. “Nippon Ishin Likely to Hold Leadership Election.” October 31, 2024. <https://www.nippon.com/en/news/yjj2024103100797/>.

¹²¹ Nippon. “CDP, Nippon Ishin Agree to Continue PM Election Talks.” October 30, 2024. <https://www.nippon.com/en/news/yjj2024103000331/>.

¹²² Kamisawa, Kazutaka. “Populist Sanseito party rising through rhetoric seen on YouTube.” The Asahi Shimbun. December 11, 2022. <https://www.asahi.com/ajw/articles/14781333>.

¹²³ Sanseito. “About Sanseito.” Accessed on November 1, 2024. <https://www.sanseito.jp/english/>.

¹²⁴ Nippon. “Ishiba’s LDP coalition Loses Majority in Japan Election: Political Uncertainty Ahead.” October 28, 2024. <https://www.nippon.com/en/japan-data/h02176/>.

PM Ishiba has signaled a measured approach to coalition-building, noting that the LDP is “not thinking of instantly forming a new coalition”.¹²⁵ From a strategic standpoint, the LDP’s position is still favorable despite the loss of its majority. Only 18 seats short of the 233 needed for control in the House of Representatives, the LDP has a relatively straightforward path to power through collaboration with either Ishin or the DPFP. Given both parties’ comparatively moderate platforms and their need for influence, it is possible that they negotiate with the LDP rather than attempt to unify under the fractured opposition’s umbrella. However, so far, no opposition parties have expressed interest in joining the LDP-Komeito coalition. This positioning compels the LDP to rely on case-by-case alliances, as forming a formal coalition may prove cumbersome.

For the opposition, the results of the elections pose both an opportunity and a challenge. The CDPJ under Yoshihiko Noda made significant strides, reflecting public dissatisfaction with the LDP’s handling of the economy and corruption scandals. However, the ideological and policy divides between the CDPJ and Ishin limit their ability to form a cohesive bloc, particularly on issues like constitutional reform, national security, and energy policy. Ishin’s Secretary-General Fumitake Fujita openly highlighted these divides, casting doubt on the opposition’s ability to present a unified alternative to the ruling party.¹²⁶ Even if all four major opposition parties come together, they would still be 11 seats short of a Lower House majority, underscoring the limitations they face despite recent gains.

In terms of governance, it is expected that Ishiba will remain in power through a minority government. Given that neither the DPFP nor Ishin have expressed interest in forming a coalition with the LDP, the parties are more likely to offer case-by-case support to overcome legislative challenges. This scenario, where Ishiba leads a minority government dependent on ad-hoc agreements, is expected to create legislative gridlock in the House of Representatives. With no single bloc holding decisive control, policy debates are likely to stall, especially on contentious issues such as economic reform. Moreover, a minority government setup might serve as a pressure point, compelling the LDP to adjust its policy approach and address the electorate’s demand for greater accountability and transparency. In the next parliamentary session, likely to be convened on November 11th, the LDP’s path forward will be determined

¹²⁵ NHK World Japan. “Ishiba: LDP, Komeito will try to retain power.” October 28, 2024.

https://www3.nhk.or.jp/nhkworld/en/news/20241028_17/.

¹²⁶ The Asahi Shimbun. “LDP scrambles for help to stay in power; gripes aired over Ishiba.” October 29, 2024.

<https://www.asahi.com/ajw/articles/15485925>.

not only by its choice of coalition partners but by its willingness to adapt to an electorate that has clearly indicated it wants change.

Policy Areas

LDP Government vs CDPJ Government on Key Issues

Figure 4: Policy divergence under an LDP and a CDPJ government

Party	Defense Policy	Migration Policy	Economic Policy
Liberal Democratic Party (LDP)	Supports revising Article 9 of the Constitution: maintain war-renouncing wording, but include explicit mention to Self-Defense Forces (SDF). Prioritizes Japan-US security alliance and seeks to bolster SDF capabilities amid regional threats such as China and North Korea.	Generally cautious about large-scale immigration. Supports limited, skill-based immigration to address labor shortages, particularly in the healthcare and construction sectors.	Focuses on fiscal stimulus, infrastructure investment, and maintaining "Abenomics"-style growth policies. Kishida's "New Form of Capitalism" emphasizes income redistribution, innovation, and addressing income inequality.
Constitutional Democratic Party (CDPJ)	Opposes constitutional revision of Article 9 and advocates maintaining Japan's pacifist stance. Supports a diplomatic approach to national security, relying on alliances and multilateralism.	Supports more progressive immigration reforms. Advocates for accepting more foreign workers and implementing stronger integration policies to counter the country's demographic decline.	Advocates for redistributive economic policies, stronger labor protections, and greater investment in social welfare. Focuses on addressing inequality, corporate regulation, and climate-related policies.

Kishida's "New Form of Capitalism" sought to balance corporate growth with wealth redistribution through investment in human capital, green technology, and digitization.¹²⁷ Nevertheless, the policy faced criticism for lacking bold and comprehensive reforms. An LDP government led by Ishiba would likely maintain a similar economic trajectory with an emphasis on defense spending, rural revitalization, and policies geared toward enhancing Japan's

¹²⁷ Prime Minister's Office of Japan. "Major policies of the Kishida Cabinet - A New Form of Capitalism." Accessed on October 22, 2024. https://japan.kantei.go.jp/ongoingtopics/policies_kishida/newcapitalism.html.

technological competitiveness. Economically, an LDP government would continue prioritizing corporate growth, incremental reforms, and policies aimed at ensuring Japan's global economic standing.

On the other hand, the CDPJ presents a more progressive economic and social vision.¹²⁸ A CDPJ-led government would likely introduce significant tax reforms aimed at reducing income inequality by shifting the burden towards higher-income earners and corporations. The CDPJ's economic agenda emphasizes stronger labor rights, enhancing social welfare programs, and expanding the role of the government in regulating corporate practices to ensure wealth redistribution. This more interventionist approach contrasts with the LDP's market-driven policies, making the CDPJ's platform appealing to voters concerned with rising inequality and stagnant wage growth. For investors, this could signal potential changes in corporate taxation and labor regulations, alongside the possibility of greater government oversight on business practices and increased social spending.

In terms of migration policy, the LDP has historically adopted a conservative stance, advocating for a selective immigration policy. This approach has prioritized addressing labor shortages in specific industries, particularly in sectors like healthcare, agriculture, and construction, while maintaining tight controls to preserve Japan's cultural homogeneity. A shift to a CDPJ-led government could lead to a more progressive and open approach to immigration policy, as the party has signaled a willingness to reform Japan's restrictive immigration system to combat the country's demographic challenges. This could mark a significant departure from the LDP's current policies, potentially opening up new opportunities for labor-intensive sectors while easing demographic pressures on Japan's economy.

The Article 9 Issue

The most significant divergence between an LDP and a CDPJ government is evident in their defense policy, particularly concerning Article 9 of the Japanese Constitution. Passing a constitutional amendment for Article 9 has been a long-term goal for the LDP. The party views the current pacifist clause, which renounces war and prohibits maintaining military forces, as outdated in light of rising regional security challenges. This stance was exemplified in 2014 when former PM Shinzo Abe bypassed the formal constitutional amendment process by 'reinterpreting' Article 9 through a cabinet decision, allowing Japan to engage in collective self-

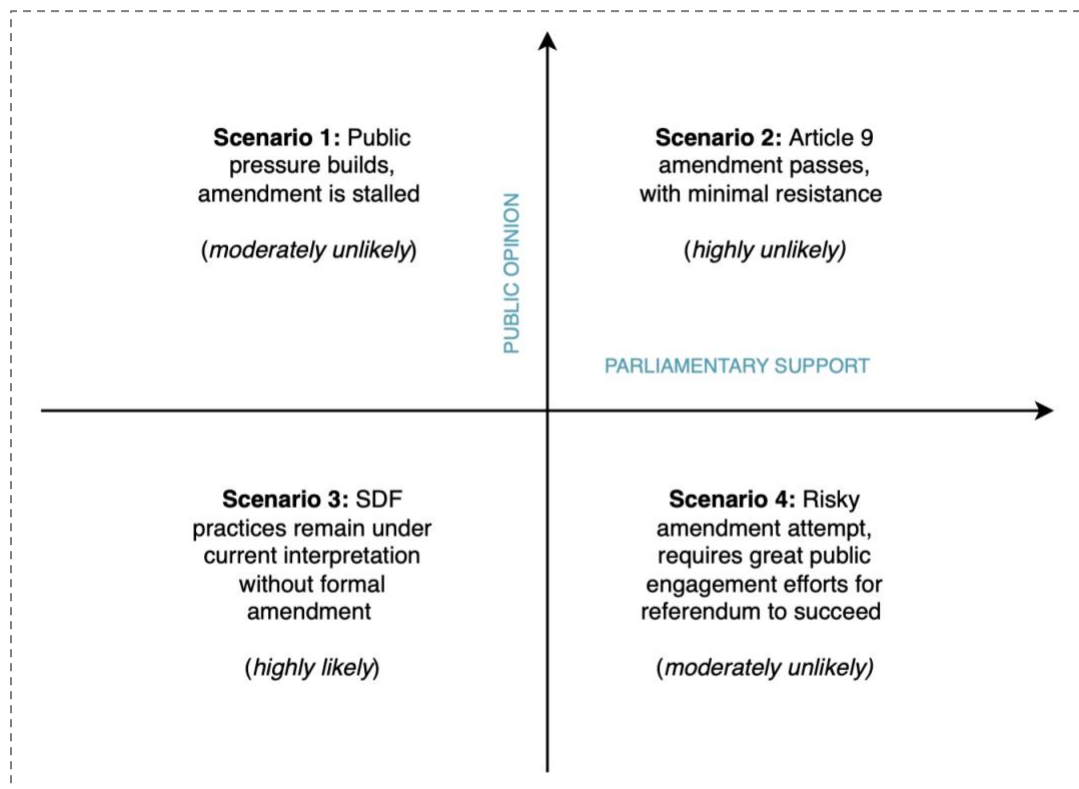
¹²⁸ The Constitutional Democratic Party of Japan. "Basic Policies." Accessed on November 1, 2024. <https://cdp-japan.jp/english/basic-policies>.

defense for the first time. Similarly, the Kishida administration continued to advocate for an enhanced defense posture, citing increasing threats from neighboring countries like China and North Korea as reasons for strengthening Japan’s military capabilities. In contrast, the CDPJ opposes any revision of Article 9 and supports maintaining Japan’s pacifist stance.

Scenario Construction II

Research Question: Will the current government try to change Article 9 of the Constitution in the current or next legislative period?

Figure 5: Scenarios on amendment of Article 9



Scenario 1: Public pressure builds, amendment is stalled (*moderately unlikely*)

This scenario is unlikely as recent exit polls from the election indicate that Japanese voters are primarily concerned with economic issues, including employment, wage growth, and overall economic stability. These concerns place economic policy firmly at the top of the legislative agenda, overshadowing any immediate push for constitutional revision. Recent polling data also shows that 65% of the Japanese population see no rush for parliamentary debates on

revision of the Constitution.¹²⁹ With economic priorities taking precedence following the election, the government is unlikely to initiate divisive constitutional changes unless public opinion drastically shifts, meaning any amendment effort would likely stall.

Scenario 2: Article 9 amendment passes, with minimal resistance (*highly unlikely*)

A constitutional amendment to Article 9 with minimal resistance is highly unlikely. In order to amend Article 9, a two-thirds majority vote in both houses of the Diet is required as well as ratification by the population in a national referendum. The outcome of the October 27th elections highlights that constitutional revision is not a priority for lawmakers. Given that the LDP no longer holds a majority in the House of Representatives, it would have to rely on support from other parties in order to pass an amendment. Additionally, public opinion remains divided on the issue, reducing any political momentum.

Scenario 3: SDF practices remain under current interpretation without formal amendment (*highly likely*)

This is the most probable outcome, with Japan continuing to operate the SDF under the existing interpretation of Article 9. The Japanese government has incrementally expanded the SDF's role within constitutional constraints to address security needs without formally amending Article 9. Given the division in the public opinion and the considerable challenges of parliamentary support, the Japanese government is not likely to change Article 9 in the current or the next legislative period.

Scenario 4: Risky amendment attempt, requires public engagement efforts for referendum to succeed (*moderately unlikely*)

This scenario is moderately unlikely, as it would require political parties to push forward with an amendment proposal despite mixed public sentiment. Although the LDP has indicated interest in revising Article 9, it is cautious about moving forward without clear public support. PM Ishiba has already signaled a cautious approach to coalition-building and policymaking following the election. This suggests that he may avoid high-stakes issues such as constitutional revision, which could strain alliances and risk further alienating the public. Finally, the LDP would first need to secure parliamentary backing in the Diet.

¹²⁹ Kyodo News, "65% feel Japan need not rush to debate Constitution revisions: poll." May 2, 2024. <https://english.kyodonews.net/news/2024/05/9b84e18c3f04-65-feel-japan-need-not-rush-to-debate-constitution-revisions-poll.html>.

Immigration Policy

Current Immigration Policy

Japan's labor shortages stem from two key issues: an inflexible employment system that is culturally resistant to integrating immigrant workers, and an immigration policy that prioritizes highly skilled labor while restricting lower-skilled workers. Unlike many countries with declining workforces that rely on immigration to fill gaps, such as the US and Germany, Japan has taken a highly selective approach, allowing only skilled professionals into permanent roles. The hiring procedures of Japanese companies for permanent employees, particularly the language and cultural competency requirements, prevent foreign workers from effectively integrating into Japan's labor market.¹³⁰

In response to these challenges, Japan's immigration policies underwent notable developments in 2023 aimed at addressing its labor shortages. In February, the cabinet approved a new visa system to attract high-income earners and skilled graduates.¹³¹ In April, discussions began on promoting study abroad exchanges for Japanese and foreign students, including work opportunities and residency pathways.¹³²

Japan has implemented the Technical Intern Training Program (TITP) and the Specified Skilled Worker (SSW) program as part of its main strategies to address labor shortages. A key challenge for Japan is to create a coherent framework for these programs that clearly defines entry and exit pathways. This framework should connect the two initiatives where applicable, offering opportunities for skills development and facilitating longer-term residency or even indefinite settlement for qualified workers.¹³³

Technical Intern Training Program (TITP)

The Technical Intern Training Program (TITP) is the primary avenue through which Japan employs less skilled foreign workers. These workers are primarily concentrated in key sectors such as manufacturing, construction, and agriculture. The TITP is structured into several stages, with a duration of three to five years depending on the industry. After the first year, participants must pass a skills test to advance to the next phase, and additional tests are required after the third year for those seeking to extend their stay by two more years. However, many of these

¹³⁰ Green, Anne E. Cole, Matthew A. Et. al. "Immigration and labor shortages: Learning from Japan and the United Kingdom." *Asian and Pacific Migration Journal* 32, no. 2 (July 2023): 336-361. <https://doi.org/10.1177/01171968231188532>.

¹³¹ Harrison, Scott. Sakudo, Mono. "Japan Needs More Labor. Is Immigration the Answer?." Asia Pacific Foundation of Canada. August 25, 2023. <https://www.asiapacific.ca/publication/japan-needs-more-labour-immigration-answer>.

¹³² Ibid.

¹³³ OECD. "Recruiting Immigrant Workers: Japan 2024." OECD Publishing. June 30, 2024. https://www.oecd.org/en/publications/recruiting-immigrant-workers-japan-2024_0e5a10e3-en.html.

assessments have not been updated in decades and often lack relevance to the evolving tasks trainees perform. In some cases, the skills being evaluated are unrelated to the actual duties carried out by the participants, raising concerns about the program's effectiveness in providing meaningful training.¹³⁴ This outdated testing framework, combined with the temporary nature of the program, complicates the long-term integration of less skilled foreign workers, making it difficult for them to establish permanent residency in Japan.

In response to the shortcomings of the TITP, the Japanese government passed an amendment to the Immigration Control and Refugee Recognition Act in June 2024. This amendment seeks to replace the TITP with a new Training Work Program for foreign workers designed to attract unskilled labor while offering a more defined criteria for obtaining permanent residency.¹³⁵ However, while the amendment represents an acknowledgement of the need to reform, it has yet to be implemented. As of today, the program remains largely ineffective in addressing Japan's current labor shortages and demographic challenges.

Specified Skilled Worker Program (SSWP)

In 2019, a new visa category known as "Specified Skilled Worker" (SSW) was introduced for over 10 fields, including manufacturing of industrial products, automotion, nursing care, construction, agriculture, hospitality, and food service, aimed at addressing labor shortages in sectors critical to Japan's economy. This visa system has two categories: SSW1, which is for mid-skilled professionals with at least three years of experience, and SSW2, which is intended for individuals classified as highly skilled. Though this policy represented a considerable departure from Japan's previous position of prohibiting the entry of foreign labor, SSW visas remain extremely strict. As of March 2022, just 64,730 workers possessed SSWI visas in Japan, representing less than 20% of the target figure.¹³⁶ Despite its intention to address workforce shortages across various industries, the SSW1 visa is limited by a five-year expiration term. Moreover, restrictions on family reunification, as well as the rigorous language and competency assessments, may dissuade potential applicants from pursuing this pathway.¹³⁷

¹³⁴ Ibid.

¹³⁵ Higuchi, Naoto. Inaba, Nanako. Et al. "Japan's paradoxical migration policy." East Asia Forum. August 16, 2024. <https://eastasiaforum.org/2024/08/16/japans-paradoxical-migration-policy/#:~:text=The%20Japanese%20government%20passed%20an,a%20new%20foreign%20worker%20program>.

¹³⁶ Green, Anne E. Cole, Matthew A. Et. al. "Immigration and labor shortages: Learning from Japan and the United Kingdom." *Asian and Pacific Migration Journal* 32, no. 2 (July 2023): 336-361. <https://doi.org/10.1177/01171968231188532>.

¹³⁷ Rehm, Maximilien Xavier. "Reevaluating Japan's landmark foreign worker reforms." East Asia Forum. May 14, 2024. <https://eastasiaforum.org/2024/05/14/reevaluating-japans-landmark-foreign-worker-reforms>.

10-year Immigration Forecast

While Japan appears to be gradually moving towards greater flexibility in its immigration policy, internal divisions and negative public sentiment are obstructing meaningful reforms and the development of a long-term immigration strategy. The implementation of comprehensive immigration reforms is challenging, resulting in a significant gap between official policy and the realities on the ground.¹³⁸

Japan currently has over 3 million foreign residents, making up 2.66% of the total population. The government forecasts that this number will rise significantly, peaking at 9.4 million by 2070, which would account for approximately 11% of the population.¹³⁹ Looking ahead, it is projected that over the next ten years, the foreign resident population will increase by about 1.39 million, bringing the total to approximately 4.39 million by 2034, or around 3.5% of the population.¹⁴⁰ However, despite this projected increase, these numbers will be insufficient to address Japan's ongoing labor shortages and declining birth rates. Japan's accelerating demographic challenges highlight the urgent need for more long-term policy planning. There are increasing demands for the retention of foreign workers to address labor shortages, but enabling long-term residency requires not only easing immigration requirements but also transforming Japan's work culture and society to better integrate foreign workers.

Japan's reliance on temporary labor programs, such as the TITP and the SSW visa, reflects a short-term approach to addressing its growing demographic and economic challenges. These programs, while helpful in filling immediate gaps in sectors like manufacturing, agriculture, and construction, are not designed as long-term immigration solutions. Both TITP and SSW limit the duration of foreign workers' stay and focus only on specific categories of labor.

In the next ten years, Japan's immigration policy is expected to continue to play a crucial role. The demographic problems derived from an aging population and a declining labor force will worsen, putting further pressure on Japan to abandon short-term labor solutions like the SSW and TITP initiatives. In the absence of a shift towards policies that promote long-term residency and workforce integration, Japan's labor force shortages are likely to deepen.¹⁴¹

¹³⁸ Angeli, Aitakerini. "Japan as an Immigration State: Reforming Japan's Labor Immigration Policy and Combating the Anti-Immigration Sentiment." *European Journal of Development Studies* 3, no. 3, 92-104. <https://doi.org/10.24018/ejdevelop.2023.3.3.257>.

¹³⁹ Harrison, Scott. Sakudo, Mono. "Japan Needs More Labor. Is Immigration the Answer?." Asia Pacific Foundation of Canada. August 25, 2023. <https://www.asiapacific.ca/publication/japan-needs-more-labour-immigration-answer>.

¹⁴⁰ French, Alice. "Japan's foreign resident population exceeds 3 million for the first time." *Nikkei Asia*. July 24, 2024. <https://asia.nikkei.com/Spotlight/Japan-immigration/Japan-s-foreign-resident-population-exceeds-3-million-for-first-time2>.

¹⁴¹ Angeli, Aitakerini. "Japan as an Immigration State: Reforming Japan's Labor Immigration Policy and Combating the Anti-Immigration Sentiment." *European Journal of Development Studies* 3, no. 3, 92-104. <https://doi.org/10.24018/ejdevelop.2023.3.3.257>.

3. SUPPLY CHAINS, TRADE AND ENERGY PROSPECTS

- In the short to medium term, Japan is likely to strengthen supply chains by reshoring some production domestically and encouraging nearshoring to ASEAN countries, supported by government incentives amid global trade uncertainties. While RCEP and CPTPP agreements enhance market access and are projected to boost Japan's GDP by 2.7% with around 570,000 jobs, returning to a consistent trade surplus will depend on sustained global demand and Japan's ability to navigate geopolitical tensions impacting exports.
- Japan's energy mix will still be dominated by fossil fuels in the short term, but nuclear and solar energy will experience rapid growth in the medium term. By 2025, renewables are expected to make up about 21% of Japan's electricity generation, with long-term plans to expand renewables to 36-38% of the energy mix by 2030.
- Inward FDI remains low (5% GDP) compared to other OECD countries, greatly due to the high barriers to entry and it is likely to experience little to no growth in the short term. Outward FDI has experienced significant growth and is expected to continue to do so in the short term as Japan seeks to cement itself as a pillar in the development of South-East Asia.

Supply Chains

Amid various security and economic challenges, the concept of globalization is now facing heightened scrutiny. In particular, Japan is reevaluating its supply chains and economic relationships in response to escalating geopolitical tensions, such as the US-China rivalry and Russia's actions in Ukraine. Concerns over societal impacts and economic security are prompting the country to implement more inward-looking policies.¹⁴² In this context, Japan is actively seeking to establish a strong domestic supply chain infrastructure while reducing its reliance on external resources. As a result, the government and corporations are exploring the advantages of adopting a more self-sufficient approach to trade.¹⁴³

¹⁴² Keidanren (Japan Business Federation). "Expectations of the OECD in an Increasingly Complex World -On the 60th Anniversary of Japan's Accession to the OECD-." Ministry of Foreign Affairs of Japan. March 15, 2024. <https://www.mofa.go.jp/files/100638629.pdf>.

¹⁴³ S&P Global. "The Evolution of Deglobalization." 2024. <https://www.spglobal.com/en/research-insights/market-insights/geopolitical-risk/evolution-of-deglobalization>.

Japan is improving its domestic supply chains and lowering its reliance on outside sources through the application of government incentives and technical developments.¹⁴⁴ The Japanese government is actively promoting the reshoring and nearshoring of supply chains through two key agencies: the Ministry of Economy, Trade, and Industry (METI) and the Japan External Trade Organization (JETRO). METI's significant support for domestic production was demonstrated by the 439 onshoring projects it sponsored between May 2020 and March 2022 across a range of industries, including electronics and semiconductors. Furthermore, JETRO has facilitated the relocation of Japanese supply chains to the Association of Southeast Asian Nations (ASEAN) by authorizing 104 nearshoring projects and offering substantial financial support of up to 5 billion yen (about \$32 million) per project.¹⁴⁵ Simultaneously, Japanese companies are investing in innovative technologies like blockchain and automation as they seek to increase supply network efficiency. These developments make supply networks more flexible in the face of geopolitical uncertainty by reducing labor needs while simultaneously boosting resilience against future crises.¹⁴⁶

Recognizing the importance of the semiconductor industry to both technological competitiveness and economic stability, the Japanese government is focusing on safeguarding it. Japan launched its “Strategy for Semiconductors and the Digital Industry” in 2021 with the goal of boosting domestic semiconductor manufacturing through substantial government funding. In order to protect national security, the Japanese Diet subsequently passed the “Economic Security Promotion Act” in 2022, which required actions to stabilize vital infrastructure and protect supply chains for essential materials. These initiatives, which are backed by an expenditure of 4 trillion yen (about \$25.4 billion), demonstrate Japan’s strategic focus on protecting industries essential for economic stability.¹⁴⁷

In the short to medium term, Japan will probably strategically restructure its supply and production chains to enhance resilience and reduce dependence on foreign suppliers, particularly through government initiatives that support domestic businesses in essential industries like semiconductors. Japanese businesses will have greater capacity to manage risks as they incorporate innovative technologies. In the context of the reshoring movement, Japanese

¹⁴⁴ Sancia. “Beyond the Deglobalization Narrative: Evolving Supply Chains in Japan.” Jusda. August 23, 2024. <https://www.jusdaglobal.com/en/article/japan-supply-chain-innovations-deglobalization-era/>.

¹⁴⁵ Xing, Yuqing. “Japan’s plan to restructure global supply chains.” East Asia Forum. August 2, 2024. <https://eastasiaforum.org/2024/08/02/japans-plan-to-restructure-global-supply-chains/>.

¹⁴⁶ Sancia. “Beyond the Deglobalization Narrative: Evolving Supply Chains in Japan.” Jusda. August 23, 2024. <https://www.jusdaglobal.com/en/article/japan-supply-chain-innovations-deglobalization-era/>.

¹⁴⁷ Xing, Yuqing. “Japan’s plan to restructure global supply chains.” East Asia Forum. August 2, 2024. <https://eastasiaforum.org/2024/08/02/japans-plan-to-restructure-global-supply-chains/>.

companies are particularly appealing because this realignment takes place at a time when Japan's expertise in materials and manufacturing technology is highly demanded. Furthermore, Japan will probably be able to maintain a sizable worldwide market share thanks to its historical advantages in manufacturing and continuous investment in R&D, creating chances for long-term, sustainable growth.¹⁴⁸

Trade

Japan has progressively adopted economic interconnectedness among key regions, enhancing its worldwide significance. Previously seen as a passive beneficiary of international trade liberalization, Japan has now established itself as a leading advocate of a rules-based economic system.¹⁴⁹ Through targeted tariff reductions and reinforced alliances with key economic partners, Japan's participation in the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) enhances its economic resilience. Despite the difficulties posed by the current geopolitical environment, these agreements not only secure essential market access for Japan but also advance its objective of asserting a leading role in global economic integration.¹⁵⁰

Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

The Trans-Pacific Partnership (TPP), which was subsequently renamed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), has expanded Japan's status as a regional economic leader. Japan's ability to lead a more comprehensive Asia-Pacific economic framework was first highlighted by TPP negotiations, which gave the country the opportunity to move beyond its customary bilateral focus with the US. With its pledge to lower tariffs on 95% of its tariff lines, Japan signaled a change from previous practices and a new level of ambition for international commerce.¹⁵¹

Former PM Shinzo Abe used Japan's status as the CPTPP's largest economy to secure the agreement's continuation when the US withdrew in 2017. In order to maintain the agreement's sustainability, Japan strategically concentrated on three important changes: easing the entry-into-force criteria, temporarily halting specific clauses, and preserving the initial commitments

¹⁴⁸ Principal Financial Group. "Japan: A Timely Investment In Deglobalization." Seeking Alpha. April 4, 2023. <https://seekingalpha.com/article/4592171-japan-timely-investment-deglobalization>.

¹⁴⁹ Solis, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 125-130.

¹⁵⁰ Katada, Soari. "Japan's continuing zeal for free trade agreements." East Asia Forum. September 3, 2024. <https://eastasiaforum.org/2024/09/03/japans-continuing-zeal-for-free-trade-agreements/>.

¹⁵¹ Solis, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 125-130.

to market access.¹⁵² Due to the addition of flexibility and the maintenance of its high standards, the CPTPP is now one of the largest free trade zones in the world, encompassing 11 Asia-Pacific countries and accounting for 13.5% to 14.5% of global GDP.¹⁵³ Beyond its financial advantages, the CPTPP unites Japan with like-minded countries like Australia and New Zealand, strengthening alliances based on common principles of democracy and the rule of law while opening up global markets and promoting economic growth.¹⁵⁴

Regional Comprehensive Economic Partnership (RCEP)

The RCEP—covering commitments to trade in goods, services, investment, intellectual property, among others—links Japan with the ASEAN nations and five other trading partners, including China and South Korea. It is now the largest free trade agreement in the world and accounts for almost 30% of global GDP,¹⁵⁵ facilitating efficient supply chain management in Asia by connecting economies in the region. Most significantly, the RCEP is Japan's first free trade agreement with South Korea and China, which together account for around 24% of the global economy.¹⁵⁶ The goal of the RCEP provisions is to progressively increase tariff-free trade by lowering tariffs on Japanese exports to China and South Korea. Because of improved trading conditions, the Japanese government expects the RCEP to boost the country's GDP by 2.7% and generate about 570,000 new jobs.¹⁵⁷ Furthermore, by supporting small and medium-sized businesses (SMEs), the RCEP offers advantages beyond tariff reductions. The agreement facilitates regional trade by requiring customs clearance within 48 hours of arrival. By protecting intellectual property and establishing restrictions on royalties, the RCEP also protects international investors.¹⁵⁸

Notwithstanding these advantageous trade agreements, current economic data from Japan indicates that reaching a trade surplus is difficult. Reduced shipments of important exports has caused Japan's exports to drop 1.7% in September 2024, the most since 2021. Due to a 2.1%

¹⁵² Ibid.

¹⁵³ Wiendieck, Sebastian. Stark, Peter. "Asia's Free Trade Agreements in Focus: CPTPP, RCEP and IPEF." Rödl & Partner. September 12, 2023. <https://www.roedl.com/insights/asia-free-trade-agreements-cptpp-rcep-ipef>.

¹⁵⁴ Ministry of Foreign Affairs of Japan. "Diplomatic Bluebook 2023: Japan's Foreign Policy to Promote National and Global Interests." September 29, 2023. https://www.mofa.go.jp/policy/other/bluebook/2023/en_html/chapter3/c030302.html.

¹⁵⁵ Shimizu, Kazushi. "RCEP's Great Impact on Japan and East Asian Economies." The Japanese Institute of International Affairs. August 2, 2022. https://www.jiia.or.jp/en/ajiss_commentary/rceps-great-impact-on-japan-and-east-asian-economies.html.

¹⁵⁶ Tan, Ivy. Hong, Kelvin. et al. "Understanding the Regional Comprehensive Economic Partnership Agreement (RCEP)." Baker McKenzie. December 2020. https://www.bakermckenzie.com/-/media/files/insight/publications/2020/12/bakermckenzie_understandingrcep_dec2020.pdf?la=en.

¹⁵⁷ Thomson Reuters Institute. "RCEP is transforming trade in Asia Pacific and creating advantages for companies." April 4, 2022. <https://www.thomsonreuters.com/en-us/posts/international-trade-and-supply-chain/rcep-asia-pacific-advantages/>.

¹⁵⁸ Boqian, OU. Bumhym, BEK. Et. al. "2023: Trilateral Economic Report." Trilateral Cooperation Secretariat. June 2023. https://tcs-asia.org/data/etcData/PUB_1688025916.pdf.

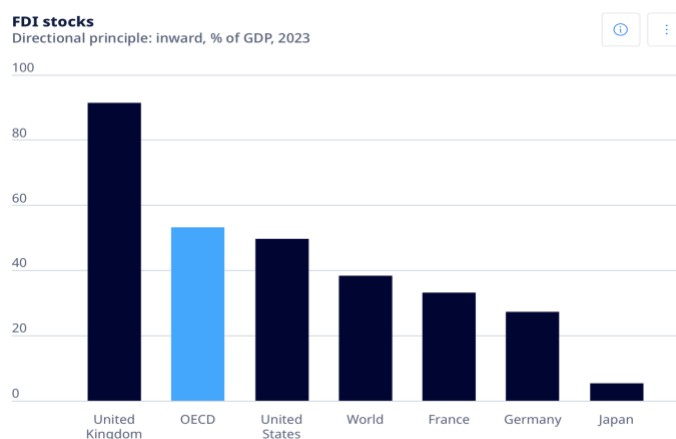
increase in imports, the trade imbalance for the month came to 294.3 billion yen (\$2 billion).¹⁵⁹ Even if the CPTPP and RCEP give Japan more access to markets and significant tariff reductions, medium-term trade surplus recovery will rely on overall global economic stability. While these trade agreements provide tariff reductions that enhance Japan's trade prospects, long-term recovery of the trade surplus will depend on global economic stability and continued demand for Japanese exports amid current geopolitical tensions.

Foreign Direct Investment (FDI)

Inward FDI

Inward FDI in Japan remains underdeveloped. The bulk of FDI is concentrated in the finance and insurance, transportation and electronic machinery sectors.¹⁶⁰ As of 2023, Japanese inward FDI was at 5% GDP.¹⁶¹ In comparison, in 2023, OECD average stood at 53% GDP while the world average stood at 38% GDP.¹⁶² Despite remaining significantly lower than its industrialized counterparts, such as the US, Germany and the UK, Japanese FDI has shown progressive improvement over the past 30 years. In 1995, FDI represented merely 0.63% of GDP¹⁶³ and in 2005, it only represented 2%.¹⁶⁴

Figure 6: Inward FDI as a % of GDP



Data Source: OECD (2023).¹⁶⁵

¹⁵⁹ Yokoyama, Erica. "Japan's exports fall most since 2021 amid global slowdown." The Japan Times. October 17, 2024.

<https://www.japantimes.co.jp/business/2024/10/17/economy/japan-exports-fall/>.

¹⁶⁰ Japan External Trade Organization. "Trends in Inwards FDI to Japan By Industry." 2023.

https://www.jetro.go.jp/en/invest/investment_environment/ijre/report2023/ch2/sec3.html.

¹⁶¹ OECD. "FDI Stocks: Inward." 2023. https://www.oecd.org/en/data/indicators/fdi-stocks.html?oecdcontrol-0be7dcf81e-var8=PT_B1GQ&oecdcontrol-e522a693d4-var1=OECD%7CFRA%7CDEU%7CJPN%7CKOR%7CGBR%7CUSA%7CW&oecdcontrol-3122613a85-var3=2023.

¹⁶² Ibid.

¹⁶³ Solís, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 6-7.

¹⁶⁴ OECD. "FDI Stocks: Inward." 2023. https://www.oecd.org/en/data/indicators/fdi-stocks.html?oecdcontrol-0be7dcf81e-var8=PT_B1GQ&oecdcontrol-e522a693d4-var1=OECD%7CFRA%7CDEU%7CJPN%7CKOR%7CGBR%7CUSA%7CW&oecdcontrol-3122613a85-var3=2023.

¹⁶⁵ Ibid.

Regardless of this gradual improvement, FDI has not experienced significant growth in recent years due to high regulatory and cost-related barriers to entry. While mergers and acquisitions represent nearly 80% of inward FDI in high income countries, it only represents 18% in Japan.¹⁶⁶ High taxes, labor shortages and overall high costs of conducting business stand in the way of FDI reaching its full potential. Additionally, in recent years, Japan has been tightening regulations through its Foreign Exchange and Foreign Trade Act (FEFTA).

In 2020, additional screening procedures were implemented to FDI, increasing bureaucracy and complicating the FDI process. With the goal of protecting national institutions and their susceptibility to external shocks, this reform saw the lowering of the threshold for government screening for foreign investors from the purchase of a 10% stake to a mere 1%. Additionally, prior and post notification requirements were implemented for investments in certain sectors, slowing the investment process and increasing costs. Lastly, different exceptions to the thresholds and notification requirements were implemented depending on whether the investor was an individual, a financial institution, or a sovereign wealth fund.¹⁶⁷

FEFTA's tightening on screening and overall regulation may, to some extent, prove to be encouraging for investors in the long term as Japan seeks to create a fertile investment environment and reach global standards on regulatory matters. Highly regulated markets paired with a devalued yen—which reached a 34-year low in 2024¹⁶⁸—present foreign investors a significant upside. However, due to Japan's historical reluctance to embrace inward FDI, the increased cost of conducting business created by the restrictions imposed through FEFTA and their FDI stagnation at 5% GDP since 2020,¹⁶⁹ it is highly likely that FDI will experience no significant growth in the short term and remain at 5% GDP through 2025.

Outward FDI (OFDI)

Japanese OFDI sits in stark contrast with its inward FDI. Represented as a percentage of GDP, as of 2023 Japanese OFDI stood at 48%, surpassing the world average of 36%.¹⁷⁰ This comes as a result of continuous efforts from the Japanese government to invest in its strategic

¹⁶⁶ Solís, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 6-7.

¹⁶⁷ Solís, Mireya, Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 6-7, 152-154.

¹⁶⁸ Shanyal, Shreyashi. "Japanese yen hits fresh 34-year low despite verbal intervention from authorities." CNBC. April 25, 2024.

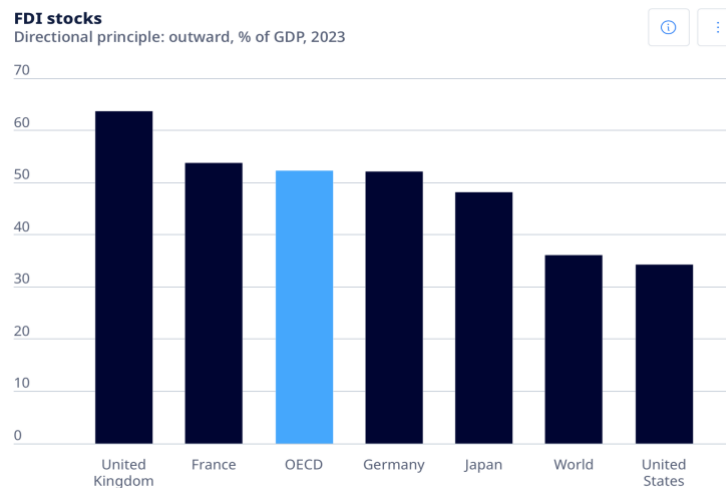
<https://www.cnbc.com/2024/04/25/japanese-yen-hits-fresh-34-year-low-despite-verbal-intervention-from-authorities-.html>

¹⁶⁹ OECD. "FDI Stocks: Inward." 2023. https://www.oecd.org/en/data/indicators/fdi-stocks.html?oecdcontrol-0be7dcf81e-var8=PT_B1GQ&oecdcontrol-e522a693d4-var1=OECD%7CFRA%7CDEU%7CJPN%7CKOR%7CGBR%7CUSA%7CW&oecdcontrol-3122613a85-var3=2023.

¹⁷⁰ OECD. "FDI Stocks: Outward." 2023. https://www.oecd.org/en/data/indicators/fdi-stocks.html?oecdcontrol-0be7dcf81e-var8=PT_B1GQ&oecdcontrol-e522a693d4-var1=OECD%7CFRA%7CDEU%7CJPN%7CKOR%7CGBR%7CUSA%7CW&oecdcontrol-3122613a85-var3=2023&oecdcontrol-975b4e0000-var6=DO.

partnerships in the region and across the world. These efforts have seen Japanese OFDI rise from \$1.15 trillion in 2014 to \$2.04 trillion in 2023.¹⁷¹ The US remains the single largest recipient of Japanese OFDI, with approximately 35% of Japan's total OFDI in 2023.¹⁷² Europe as a region is Japan's second largest recipient of OFDI and Asia is the third. Within Asia, however, there is a particular focus on the ASEAN countries, receiving over one third of all Japanese OFDI in Asia.¹⁷³

Figure 7: Outward FDI as a % of GDP



Data Source: OECD (2023).¹⁷⁴

Japan seeks to establish itself as the top player in South and South-East Asia through OFDI and bilateral credit agreements. In 2023, Japanese OFDI was significantly directed towards investments in the region. In said year, OFDI in Singapore, Thailand, Indonesia, Malaysia, Philippines, Vietnam, and India was concentrated on manufacturing, wholesale and retail, and finance and insurance.¹⁷⁵ Japanese investments in said nations are particularly intense in the manufactured goods sector due to Japan's labor shortages and the comparatively cheaper labor in the region. OFDI in the ASEAN is the result of Japanese investors moving away from China, looking to hedge their investments in an attempt to protect themselves from possible external shocks. Investments in the region along with multilateral and bilateral agreements such as the Japanese-American FTA on mineral sourcing are two of the leading strategies implemented as

¹⁷¹ Statista. "Japan's outward foreign direct investment (FDI) stock from 2014-2023." 2024. <https://www.statista.com/statistics/811280/japan-outward-fdi-stock/>.

¹⁷² Bank of Japan. "Direct Investment Flows 2023: Outward FDI by Country/Region." 2023. https://www.mof.go.jp/english/policy/international_policy/reference/balance_of_payments/ebpfdi.htm.

¹⁷³ Ibid.

¹⁷⁴ OECD. "FDI Stocks: Outward." 2023. https://www.oecd.org/en/data/indicators/fdi-stocks.html?oeecdcontrol-0be7dcf81e-var8=PT_B1GQ&oeecdcontrol-e522a693d4-var1=OECD%7CFRA%7CDEU%7CJPN%7CKOR%7CGBR%7CUSA%7CW&oeecdcontrol-3122613a85-var3=2023&oeecdcontrol-975b4e0000-var6=DO.

¹⁷⁵ Bank of Japan. "Direct Investment Flows 2023: Outward." 2023. https://www.mof.go.jp/english/policy/international_policy/reference/balance_of_payments/ebpfdi.htm.

Japan seeks to become increasingly self-reliant as it reduces its exposure to supply-chain shortages and inefficiencies.

As it pertains to credit agreements, in 2022, Japanese credits to South Asian countries reached \$40.7 billion, making it the top bilateral creditor with a 36% share of total bilateral credits in the region.¹⁷⁶ Through bilateral credit agreements, Japan has surpassed China as the top bilateral creditor in the region. Additionally, through the Development Assistance Committee (DAC) and Official Development Assistance (ODA), Japan has become a leading force in infrastructure finance. As a response to China's Belt and Road Initiative (BRI), former PM Shinzo Abe launched Japan's Partnership for Quality Infrastructure (PQI), a \$110 billion fund (which later rose to a capitalization of \$200 billion), as a sign of further commitment in promoting infrastructure development in the region, particularly in South and South-East Asia.¹⁷⁷ Via bilateral agreements promoted by the ODA and PQI, or through multilateral institutions such as the DAC, OECD and the Asia-Pacific Economic Cooperation (APEC), it is highly likely that Japan will continue to pursue infrastructure development in the region and therefore continue to invest and cement itself as the region's top creditor in the short term.

South Asia is expected to be the fastest growing region in the developing world through 2024.¹⁷⁸ While concerns in regards to the region's debt sustainability exist, it is likely that Japan will continue to invest in the region and maintain its position as a top creditor in the short term in order to gain influence and hedge against its investments in China. Especially as Indonesia and Thailand seek to gain a membership into the OECD in the distant future, Japan is expected to play a vital role as a bridge between the region and the OECD, further incentivising Japanese investments in the region and positioning Japan as a champion for regional stability.¹⁷⁹

Energy

As outlined in its Sixth Strategic Energy Plan, Japan's energy strategy is currently defined by two factors: ensuring energy security and advancing decarbonization efforts. The former is explained by Japan's negligible hydrocarbon reserves, making it extremely dependent on

¹⁷⁶ Samal, Prateek and Tin Yu To, Anthony. "Up & coming: unpacking South Asia's growing role in global debt." World Bank. March 13, 2024. <https://blogs.worldbank.org/en/opendata/coming-unpacking-south-asias-growing-role-global-debt>.

¹⁷⁷ Solís, Mireya. Japan's Quiet Leadership: Reshaping the Indo-Pacific. (Washington D.C.: Brookings Institution Press, 2023), 6-7, 134-135.

¹⁷⁸ Samal, Prateek and Tin Yu To, Anthony. "Up & coming: unpacking South Asia's growing role in global debt." World Bank. March 13, 2024. <https://blogs.worldbank.org/en/opendata/coming-unpacking-south-asias-growing-role-global-debt>.

¹⁷⁹ Seya, Sukegawa. "Japan as a Bridge Between ASEAN and the OECD." The Diplomat. June 20, 2024. <https://thediplomat.com/2024/06/japan-as-a-bridge-between-asean-and-the-oecd/>.

imports of oil, natural gas and coal. Almost 90% of Japan's energy supply is imported,¹⁸⁰ particularly from politically unstable regions like the Middle East, exposing the nation to supply chain disruptions, price volatility, and geopolitical risks. In the wake of the Fukushima Daiichi nuclear disaster in 2011, Japan reduced its reliance on nuclear energy. However, support for nuclear energy is expanding among policymakers and industrial stakeholders, despite lingering public discontent and safety concerns stemming from the Fukushima disaster.

At the same time, Japan's energy strategy is increasingly influenced by its decarbonization goals, with a commitment to achieve carbon neutrality by 2050. The need to reconcile energy security with climate commitments has led Japan to adopt a "green growth" approach,¹⁸¹ encouraging investments in clean energy technologies while maintaining a stable and diversified energy mix.

Energy and Electricity Mix

Japan's energy mix is currently dominated by the hydrocarbons sector. In 2023, total energy supply was composed of 37.7% oil, 26.1% coal, 21% natural gas, 9.4% renewables and 5.8% nuclear.¹⁸² The overall energy consumption (or demand) is expected to decrease due to a declining population and implementation of energy-efficient measures. Nevertheless, this forecast is tempered by increasing investments in energy-intensive industries, such as semiconductors and data centers, which could partially offset expected demand reductions. As a result, Japan is supporting the restart of nuclear power plants to meet growing energy needs. In terms of growth, nuclear power will be the fastest growing sector in the short term followed by solar power in the energy mix (64 TWh and 15TWh, respectively in 2023).¹⁸³

In 2023, 33.4% of electricity generation came from non-fossil fuels (11.2% solar, 7.7% nuclear, 7.5% hydropower, among other sources),¹⁸⁴ despite gas and coal being the main two sources (29.0% natural gas, 28.3% coal). The industrial sector will keep representing the highest volume of electricity consumption and will continue to do so in the short and medium term. Services and household consumption make up 34% and 26% of total consumption, respectively.¹⁸⁵

¹⁸⁰ IEA. "Japan - Energy supply." Accessed on October 23, 2024. <https://www.iea.org/countries/japan/energy-mix#where-does-japan-get-its-energy>.

¹⁸¹ Government of Japan. "Japan's Green Growth Strategy Will Accelerate Innovation." September 16, 2021. https://www.japan.go.jp/kizuna/2021/09/green_growth_strategy.html.

¹⁸² IEA. "Japan - Energy supply." Accessed on October 23, 2024. <https://www.iea.org/countries/japan/energy-mix#where-does-japan-get-its-energy>.

¹⁸³ Our World in Data. "Japan: Country Profile." Accessed on October 19, 2024. <https://ourworldindata.org/energy/country/japan>.

¹⁸⁴ Institute for Sustainable Energy Policies. "2023 Share of Electricity from Renewable Energy Resources in Japan [Preliminary Report]." June 10, 2024. <https://www.isep.or.jp/en/1529/>.

¹⁸⁵ Enerdata. "Japan Energy Information | Enerdata." Accessed on October 20, 2024. <https://www.enerdata.net/estore/energy-market/japan/>.

Hydrocarbons

Despite its limited fossil fuel reserves, this source represents over 80% of Japan's primary energy consumption and approximately 65% of its electricity generation.¹⁸⁶ Japan is also the sixth largest consumer of crude oil in the world.¹⁸⁷ In 2023, Japan's primary oil supplier was the United Arab Emirates, followed by Saudi Arabia and Kuwait. Japan's long-standing reliance on Middle Eastern oil has been a central concern for its energy security. While Japan is likely to remain a significant importer from the region in the medium term, it is actively working to reduce this dependency by exploring opportunities in liquified natural gas (LNG) and renewable energy sources.

In the medium term, Japan is likely to continue relying on traditional energy suppliers. However, its exploration of alternative LNG and coal sources, including countries in North America and Africa, signals a commitment to reduce dependency on a few key regions. Japan remains one of the world's largest coal importers, sourcing 64.5% from Australia.¹⁸⁸ Since mid-2022, Japan has reduced its coal imports from Russia and, in turn, increased imports from other sources, including Indonesia, South Africa, and occasionally the Americas, with shipments arriving from Canada, Colombia, and the US.

Japan also ranks as the world's second largest LNG importer. In 2023, its main suppliers were Australia, Malaysia and Russia. In an effort to diversify its suppliers after the war in Ukraine, Japan has looked towards African countries such as Mozambique for LNG. Japan's domestic LNG demand has been steadily declining due to increased generation from nuclear and renewable energy sources. This shift has led to a 25% decrease in domestic LNG demand between 2014 and 2023, with forecasts projecting another 25% reduction by 2030.¹⁸⁹ Reflecting this trend, Japan reduced its LNG imports by 7.8% in 2023 compared to 2022.¹⁹⁰

As domestic LNG consumption wanes, Japan faces challenges with its existing long-term LNG contracts. Typically, these contracts are designed to secure steady energy supplies but may not be easily reduced, leading to over-contracting—a situation where the contracted LNG supply

¹⁸⁶ Energy Institute. "Statistical Review of World Energy 2024." June 20, 2024. 49.

https://www.energyinst.org/_data/assets/pdf_file/0006/1542714/684_EI_Stat_Review_V16_DIGITAL.pdf.

¹⁸⁷ Statista Research Department. "Oil consumption share worldwide in 2010 and 2023, by country." Statista. July 15, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/273565/share-of-the-major-consuming-countries-in-global-oil-consumption/>.

¹⁸⁸ Energy Institute. "Statistical Review of World Energy 2024." June 20, 2024. 49.

https://www.energyinst.org/_data/assets/pdf_file/0006/1542714/684_EI_Stat_Review_V16_DIGITAL.pdf.

¹⁸⁹ Denis-Ryan, Amandine. Runciman, Josh. "Japan does not need Australian LNG to keep the lights on in Tokyo." Institute for Energy Economics and Financial Analysis. May 17, 2024. <https://ieefa.org/resources/japan-does-not-need-australian-lng-keep-lights-tokyo>.

¹⁹⁰ Energy Institute. "Statistical Review of World Energy 2024." June 20, 2024. 43-45.

https://www.energyinst.org/_data/assets/pdf_file/0006/1542714/684_EI_Stat_Review_V16_DIGITAL.pdf.

exceeds current demand. To manage this surplus, Japan resells LNG to other countries, particularly targeting emerging Asian markets such as Indonesia, Malaysia and the Philippines, where energy demand continues to rise. Japan's LNG sales to third countries doubled to 31.6 million tons in fiscal 2022 from fiscal 2018.¹⁹¹

Nuclear Energy

In the short term, Japan is advancing its commitments to nuclear energy by gradually restarting nuclear units under new security and safety measures. As a result, in 2023 nuclear output increased by 49.6%.¹⁹² As of February 2024, Japan restarted 12 nuclear units, bringing current operating nuclear capacity to 11 GW.¹⁹³ In the midst of the war between Russia and Ukraine, the Japanese government passed a bill that allows nuclear reactors in the country to be operated beyond the current limit of 60 years. As a result, Japan has 33 nuclear power reactors classed as operable.

Japan's pledge to achieve carbon neutrality by 2050 has also contributed to the push for nuclear reactivation, as nuclear power provides a stable, carbon-free source of electricity. According to Japan's Sixth Strategic Energy Plan, 20-22% of Japan's energy demand in 2030 would be met by nuclear power. However, public support for nuclear energy remains mixed; while some recognize its importance for reducing emissions, safety concerns persist among the broader population. In response, the government has intensified public engagement efforts and transparency about nuclear safety measures, aiming to rebuild public trust.

Renewable Energy

While Japan has set ambitious renewable energy targets and shows promising growth in solar and offshore wind capacity, investment declines and regulatory barriers pose challenges to effectively achieving its energy goals. Japan's Sixth Strategic Energy Plan aims to raise the share of renewables in the power mix to 36-38% (including hydropower) in 2030, with plans to make renewables the main power source in 2050.¹⁹⁴ Japan ranks sixth worldwide in installed renewable energy capacity,¹⁹⁵ and is steadily expanding its electricity production from renewable sources, which accounted for 25.7% of total electricity production in 2023. Despite

¹⁹¹ JOGMEC. "Results of FY2023 Survey on LNG Handling Volume by Japanese Companies." November 10, 2023. https://oilgas-info.jogmec.go.jp/nglng_en/handling_volume/1009927.html.

¹⁹² Energy Institute. "Statistical Review of World Energy 2024." June 20, 2024.

https://www.energyinst.org/_data/assets/pdf_file/0006/1542714/684_EI_Stat_Review_V16_DIGITAL.pdf.

¹⁹³ U.S. Energy Information Administration. "Nuclear reactor restarts in Japan have reduced LNG imports for electricity generation." *eai.gov*. February 8, 2024. <https://www.eia.gov/todayinenergy/detail.php?id=61386>.

¹⁹⁴ Ministry of Economy, Trade and Industry. "Strategic Energy Plan." October 2021.

https://www.enecho.meti.go.jp/category/others/basic_plan/pdf/strategic_energy_plan.pdf.

¹⁹⁵ Fernández, Lucía. "Leading countries in installed renewable energy capacity worldwide in 2023 (in gigawatts)." Statista. April 17, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/267233/renewable-energy-capacity-worldwide-by-country/>.

this potential, investments in renewable energy have been decreasing, from \$14.54 billion in 2020 to \$7.53 billion in 2022,¹⁹⁶ due to financial and regulatory barriers.

Solar energy is also integral in Japan's renewable energy potential and is expected to make up 11-16% of the country's energy mix by 2030. In 2023, Japan's total installed solar capacity stood at 87 GW, 4.8% more than the previous year. Although this capacity is significantly lower than China's—which exceeds 600 GW of installed photovoltaic power, making China the world leader in installed photovoltaic capacity—Japan ranks third globally.¹⁹⁷ A key driver of Japan's solar capacity growth in the short term is its feed-in tariff (FiT) program, which supports commercial, industrial, and residential solar installations for 2024 and 2025.¹⁹⁸

Offshore wind represents a significant opportunity for Japan, given its extensive coastline. Japan aims to have 10 gigawatts (GW) of offshore wind power projects by 2030 and up to 45 GW by 2040. To this end, the government passed a law that allows for the installation of offshore wind power in exclusive economic zones. The country currently has just over 5 GW of total wind capacity installed, of which 2.9% is offshore wind.¹⁹⁹

¹⁹⁶ Klein, Catharina. "Investment in clean energy in Japan from 2017 to 2022." Statista. January 11, 2024. <https://www-statista-com.ezproxy.unav.es/statistics/1206628/japan-new-investment-clean-energy/>.

¹⁹⁷ REN21. *Renewables 2024 Global Status Report Collection: Energy Supply*. Paris: REN21 Secretariat, 2024. 65-66. https://www.ren21.net/wp-content/uploads/2019/05/GSR2024_Supply.pdf.

¹⁹⁸ Yuen, Simon. "Japan announces feed-in tariffs for residential and C&I PV systems." PV Tech. March 21, 2024. <https://www.pv-tech.org/japan-feed-in-tariffs-2024-2025/>.

¹⁹⁹ Energy Institute. "Statistical Review of World Energy 2024." June 20, 2024. 62. https://www.energyinst.org/_data/assets/pdf_file/0006/1542714/684_EI_Stat_Review_V16_DIGITAL.pdf.

4. GEOPOLITICAL RISK

- Japan is unlikely to decouple its economy from China, maintaining its trade relationship while also strengthening ties with other regional partners. However, escalating tensions over Taiwan could disrupt critical supply chains. A regional conflict could also jeopardize energy security, as over 90% of Japan's crude oil and 60% of its natural gas transit through the South China Sea, resulting in higher transportation costs and economic repercussions.
- It is improbable that Japan's alignment with the US will damage Japanese economic interests in the medium term. Due to Japan's deeply embedded economic ties with the US, China and the Indo-Pacific region in general, it is doubtful that China would seek to damage or sever its ties to Japan.
- Japan is positioned to develop its own military technology in the long term, supported by a record \$59.76 billion budget request for defense for 2025 and a focus on advanced technology development. Despite challenges in domestic production and market competitiveness, Japan's defense strategy reflects a commitment to becoming a more prominent player in the global arms market.

Sino-Japanese Trade Relations

Japan's bilateral relationship with China is still characterized by its economic dependency, and any efforts to dissolve these ties would be extremely difficult. China remains Japan's main trade partner, and both countries have made stabilizing economic ties a top priority in the context of continuing regional economic integration, which is exemplified by multilateral agreements like the RCEP. Complete decoupling from China is not currently the goal of Japan's economic security.²⁰⁰ Japan and many other countries in the Asia-Pacific region depend on their economic relations with China for their continued prosperity. Japan has little choice but to look for ways to manage coexistence with China in order to achieve long-term economic stability.²⁰¹

²⁰⁰ Aoyama, Rumi. "Japan and China's economies are adapting, not decoupling." East Asia Forum. June 27, 2024. <https://eastasiaforum.org/2024/06/27/japan-and-chinas-economies-are-adapting-not-decoupling/>.

²⁰¹ Kawakatsu Ueki, Chikako. "Japan's China Strategy: The End of Liberal Deterrence?." Security Challenges 16, no. 3 (2020): 58-63. <https://www.jstor.org/stable/26924341>.

If rivalry in the Far East intensifies, the economic relations between China and Japan would become turbulent, marked by growing insecurity. Increasing hostilities may cause regional supply chains and maritime routes to be affected creating security and economic disturbances.²⁰² Despite their current interdependence, China and Japan might seek to reduce reliance on one another in response to escalating hostilities. Japan would aim to navigate this landscape by enhancing its economic partnership with other regional actors, such as South Korea. This strategy would be supported by Japan's participation in trade agreements like the CPTPP, which facilitate closer economic ties and collaborative opportunities among other member states of the region.²⁰³

Taiwan continues to be the most unstable flashpoint as it pertains to Japan's relationship with China. The likelihood of a Chinese military assault on Taiwan is increasing, and a confrontation of that nature would have severe economic consequences for Japan. Taiwan supplies more than 60% of Japan's semiconductor chip imports, a number that continues to rise, while China supplies over 45% of Japan's electronic equipment.²⁰⁴ As a result, Japanese businesses are largely dependent on imports from both countries. The effects on Japan's economy would be profound if trade with any or both of these nations were disrupted.²⁰⁵ Apart from semiconductors, Taiwan ranks as Japan's fourth largest trading partner regarding both exports and imports. The total bilateral trade volume between the nations reached a record high of \$88.2 billion in 2022.²⁰⁶ Japan would lose important technological resources if Taiwan were to fall under Chinese control, in addition to China gaining supremacy in semiconductor technology. Japan might be forced to change its trade strategies as a result of this change, which could make it more dependent on its allies in the West.

Japan's energy security is a further area of concern. In the case of a war over Taiwan, China might block the South China Sea, which is where more than 90% of Japan's imports of crude oil and 60% of its natural gas transit.²⁰⁷ If China were to take control of important shipping lanes, such the Bashi Channel, Japan's energy supply would be severely disrupted, forcing it to take a far more expensive and time-consuming detour. Increased transportation costs would

²⁰² Tanaka, Hitoshi. "Navigating China Relations and the US-Japan Alliance." East Asia Insights (Japan Center for International Exchange). October 2020. <https://jcie.org/analysis/east-asia-insights/east-asia-insights-navigating-china-relations-us-japan-alliance/>.

²⁰³ Aoyama, Rumi. "Japan and China's economies are adapting, not decoupling." East Asia Forum. June 27, 2024. <https://eastasiaforum.org/2024/06/27/japan-and-chinas-economies-are-adapting-not-decoupling/>.

²⁰⁴ Yasuyuki, Todō. "Japan's Supply Chains at Risk: Preparing for a Taiwan Contingency." Nippon. June 12, 2023. <https://www.nippon.com/en/in-depth/d00907/>.

²⁰⁵ Ibid.

²⁰⁶ National Development Council. "JCCI affirms the substantial results of coordination by the NDC and pledges to continue to enhance Japan-Taiwan relations." October 6, 2023. https://www.ndc.gov.tw/en/nc_8455_37472.

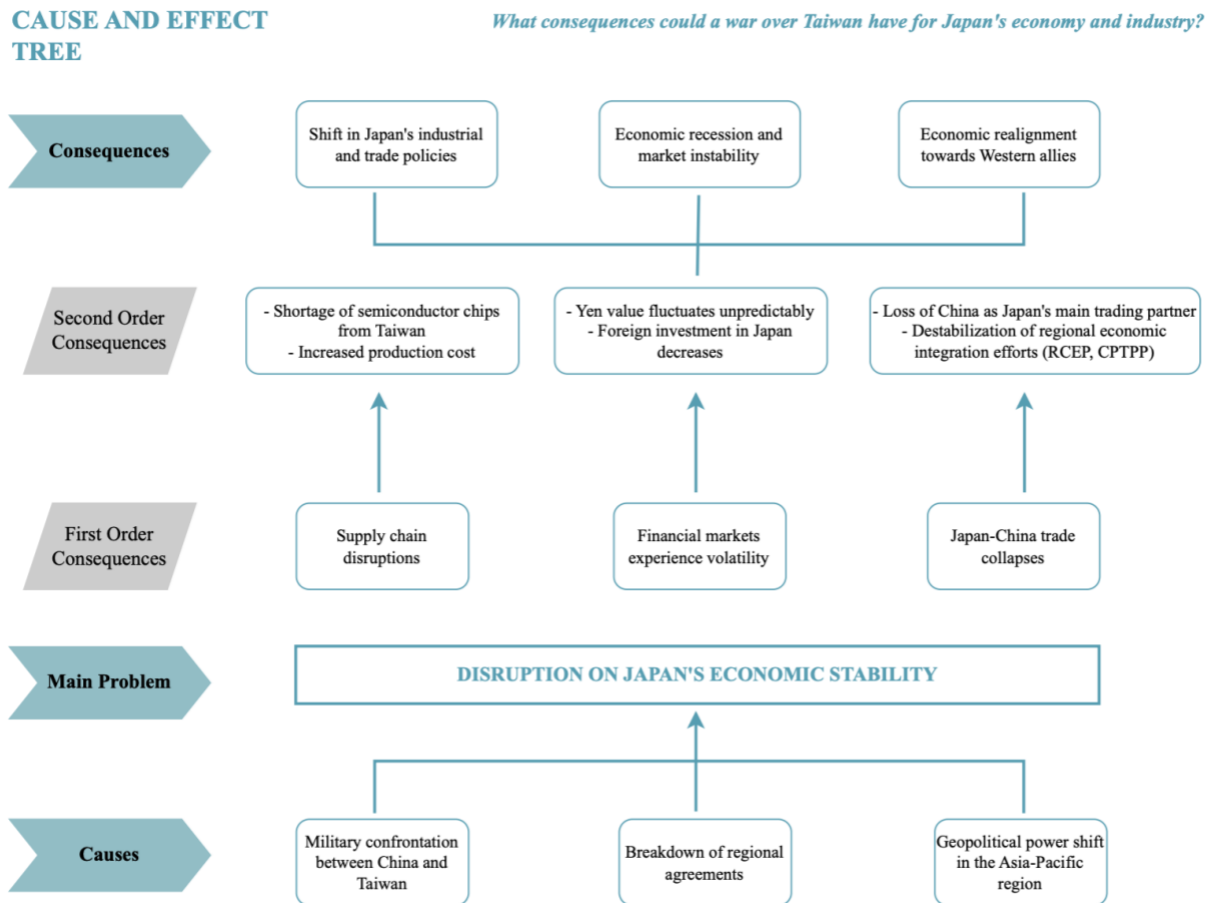
²⁰⁷ Kamiya, Mataka. "China's Takeover of Taiwan Would Have a Negative Impact on Japan." *Pacific Forum International* 23, no. 2 (January 2023): 29-41. https://pacforum.org/wp-content/uploads/2024/01/IssuesandInsights_VOL23_SR2.pdf.

raise the selling price of domestic goods, which would also be damaging to the Japanese economy.²⁰⁸

Cause and Effect Tree

Research Question: What consequences could a war over Taiwan have for Japan’s economy and industry?

Figure 8: Cause and Effect Tree



US-Japan Relations

As Japan seeks to establish itself as the leading power in the Indo-Pacific, its relationship with the US will continue to be of crucial importance. The symbiotic relationship between the two powers in the region is what enables the US to keep a pulse on the region while Japan continues to expand its economic interests. It is likely that this relationship will aid Japan in reaching its economic interests in the medium term.

²⁰⁸ Ibid.

Similar to the geopolitical environment encountered during the Cold War, two blocs continue to control global power dynamics. The Western Bloc continues to be led by the US, however, the Eastern Bloc, formerly led by the USSR is currently in a power struggle between Russia and China. Regardless of who is the driving force behind the Eastern Bloc, the fact remains that the world is polarized and power dynamics are constantly shifting and under immense pressure. Due to this division and the geographical circumstances of this global power struggle, Japan's alignment with the US poses both advantages and disadvantages in the short to medium term.

US-Japan relations have proven to be mutually beneficial over time. Through their continued partnership since the Second World War and the subsequent Treaty of Mutual Cooperation and Security (1960), the US has established a significant military presence in the region, placing over 50,000 military personnel in Japanese territory spread across 85 facilities.²⁰⁹ This cooperation has allowed the US to boast a significant military presence in the region while providing Japan with a robust security umbrella. The military and defense-centric facet of this partnership has enabled the US to become an effective deterrent against Chinese aggression in the region. It is highly likely that security will remain a priority for both parties in order to ensure further stability in the region, particularly as tensions remain in regards to Taiwan and the South China Sea.

From an economic perspective, US-Japan relations are best understood through their mutual collaboration and participation in international organisms, trade agreements and deeply embedded reciprocal FDI. The US and Japan's relationship will continue to be a top priority for both parties in the long term. In matters of trade, Japan remains the US' sixth largest trade partner, importing roughly \$187 billion and exporting roughly \$120 billion.²¹⁰ Japan also remains one of the US' main sources for FDI.²¹¹ Additionally, Japanese investors hold the top position as the main holders of US Treasury bonds.²¹² More recently, the US and Japan have signed a Crucial Minerals Agreement (CMA) which seeks to strengthen both nations' supply chain resilience, particularly in the tech sector.²¹³ Added to the previous US-Japan Trade Agreement (USJTA) and the US-Japan Digital Trade Act, it is clear that both nations seek to continue to further develop their economic ties and are highly likely to continue to do so in the medium term.

²⁰⁹ US Forces Japan. "About USFJ." Accessed on October 25, 2024. <https://www.usfj.mil/About-USFJ/>.

²¹⁰ Congressional Research Service. "US-Japan Relations." August 1, 20204. <https://crsreports.congress.gov/product/pdf/IF/IF10199>.

²¹¹ Ibid.

²¹² Ibid.

²¹³ Congressional Research Service. "US-Japan Trade Agreements and Negotiations." April 3, 2024. <https://crsreports.congress.gov/product/pdf/IF/IF11120>.

Additionally, as the Indo-Pacific continues as the world's fastest growing economy, Japan offers the US access to the region. As stated in the White House's 2022 Indo-Pacific Strategy, the US seeks to become a "driver" of regional prosperity and a "builder".²¹⁴ The US' rhetoric in regards to the region indicates that in years to come, the Indo-Pacific will be one of its main areas of focus as it seeks to embed itself in the region's economy. This vision was materialized in 2022 through the Indo-Pacific Economic Framework for Prosperity (IPEF) which sought to expand US leadership in the region.²¹⁵ Japan will play a crucial role in allowing the US to immerse itself in the region as both parties seek to foster economic growth and development in the Indo-Pacific.

Despite aligning with the US, it is unlikely that said partnership will damage Japanese economic interests in the medium term. Japan has had strong ties to the US and has been under its security umbrella since the end of the Second World War, and still continues to develop its economic relationship with China without much hindrance. As long as matters regarding China and the South China Sea remain stable, Sino-Japanese relations are likely to continue to persist uninterrupted. Japan's multilateralism and push for a rules-based international order will continue to foster stable relationships with both the US and China.

As it pertains to the stability of this alliance, from the US' point of view, Japan is indispensable and regardless of the outcome of the 2024 presidential elections, American bipartisan support suggests that it will remain strong.²¹⁶ From a Japanese perspective, the same can be said despite the political uncertainty derived from these past October elections. Regardless of the government formed within the next few weeks, the US will remain a key partner for Japan in security and economic policies going forward.

Road Towards Remilitarization?

Japan has made significant strides in developing its military technology, especially since the unveiling of key strategic documents—the National Security Strategy (NSS), National Defense Strategy (NDS), and Defense Build-up Plan (DBP)—in 2022. These documents lay out a plan to increase defense spending to 2% of GDP by 2027, with a projected total defense expenditure

²¹⁴ The White House. "Indo-Pacific Strategy." February 2022. <https://www.whitehouse.gov/wp-content/uploads/2022/02/U.S.-Indo-Pacific-Strategy.pdf>.

²¹⁵ The White House. "FACT SHEET: In Asia, President Biden and a Dozen Indo-Pacific Partners Launch the Indo-Pacific Economic Framework for Prosperity." May 23, 2022. <https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/23/fact-sheet-in-asia-president-biden-and-a-dozen-indo-pacific-partners-launch-the-indo-pacific-economic-framework-for-prosperity/>.

²¹⁶ Liff, Adam P. "Japan: America's indispensable ally." Brookings Institution. September 16, 2024. <https://www.brookings.edu/articles/japan-americas-indispensable-ally/>.

of 43 trillion yen (\$325 billion) between fiscal years 2023/24 and 2027/28. This marks a substantial shift from Japan's historical cap of 1% of GDP on defense, signaling a greater focus on enhancing its military capabilities. In line with this pledge, the Ministry of Defense requested a 8.54 trillion yen (\$59.76 billion) budget for fiscal year 2025/26, its largest budget request to date.²¹⁷

Demonstrating its efforts to improve arms capabilities, Japan imported 155% more arms between 2019 and 2023 compared to the period between 2014 and 2018, making it the sixth largest arms importer during that time.²¹⁸ The US remains Japan's main arms supplier, accounting for 97% of arms imports, with Japan being the US's second-largest arms client, behind Saudi Arabia.²¹⁹

It is probable that Japan will develop its own military technology in the long term. As outlined in the Ministry of Defense's "Defense Technology Guideline 2023," Japan is adopting a dual track strategy to developing defense technology: focusing on near-term technologies critical for national security and the long-term development of disruptive, dual-use innovations.²²⁰ The country has also significantly increased its defense R&D budget, with a 67.5% rise in 2023 over 2022.²²¹ Moreover, Japan's Advanced Defense Technology Center, modeled after US agencies like the Defense Advanced Research Projects Agency (DARPA), is a significant step in enhancing the nation's military technologies.²²² The center aims to achieve technological superiority, rapidly field new defense technologies within three years, develop dual-use technologies with civilian application, and promote international collaboration.

With regards to its potential as an arms exporter, Japan's defense industry faces structural challenges, primarily due to high production costs and limited competitiveness. The government's import substitution policy, which spreads defense contracts across diverse production lines, raises unit costs, contributing to over 100 defense contractors exiting the market in the last two decades.²²³ Additionally, past export restrictions limited Japan's defense

²¹⁷ Darling, Daniel. "No Going Back: Japan Continues to Hike Defense Spending." *Defense and Security Monitor*. September 12, 2024. <https://dsm.forecastinternational.com/2024/09/12/no-going-back-japan-continues-to-hike-defense-spending/>.

²¹⁸ Wezeman, Pieter D. Djokic, Katarina. et al. "Trends in International Arms Transfers, 2023." *Stockholm International Peace Research Institute*. March 2024. https://www.sipri.org/sites/default/files/2024-03/fs_2403_at_2023.pdf.

²¹⁹ *Ibid*.

²²⁰ Japan Ministry of Defense. "Defense Technology Guideline 2023." June 2023.

https://www.mod.go.jp/atla/guideline2023/assets/pdf/technology_guideline2023.pdf.

²²¹ Statista Research Department. "Governmental budget for national defense expenditure on research and development (R&D) in Japan from fiscal year 2014 to 2023." *Statista*. January 17, 2024. <https://www.statista.com/statistics/1362117/japan-defense-budget-research-and-development/>.

²²² Ng, Jr. "Japan announces new defence technology accelerator." *Asian Military Review*. August 16, 2024.

<https://www.asianmilitaryreview.com/2024/08/japan-announces-new-defence-technology-accelerator/>.

²²³ Takeuchi, Yusuke. "Japan passes defense subsidy bill to stop industry bleeding." *Nikkei Asia*. June 8, 2023.

<https://asia.nikkei.com/Business/Aerospace-Defense-Industries/Japan-passes-defense-subsidy-bill-to-stop-industry-bleeding>.

companies to the Japan SDF as their primary client, hindering revenue growth. In 2022, defense sales accounted for just 10% and 14% of Mitsubishi Heavy Industries and Kawasaki Heavy Industries' revenue, respectively.²²⁴ However, the Kishida cabinet's decision to export next-generation fighter jets, developed with Italy and the UK under the Global Combat Air Program (GCAP), shows promise for future export potential.²²⁵ Japan had originally been working on a domestic fighter, the F-X, but in December 2022, it decided to merge this project with the British-Italian Tempest program, targeting deployment in 2035. The joint initiative is headquartered in the UK and aims to replace Japan's aging fleet of US-designed F-2 fighters. Full-scale exports may not be imminent, but with continued investment and collaboration with allies, Japan could emerge as a more significant player in the global defense market in the long term.

²²⁴ Stockholm International Peace Research Institute. "The SIPRI Top 100 arms-producing and military services companies in the world, 2022." December 2023. <https://www.sipri.org/visualizations/2023/sipri-top-100-arms-producing-and-military-services-companies-world-2022>.

²²⁵ Maslow, Sebastian. "Kishida's arms exports aim to bolster Japan's global military cooperation." East Asia Forum. May 19, 2024. <https://eastasiaforum.org/2024/05/19/kishidas-arms-exports-aim-to-bolster-japans-global-military-cooperation/>.

CONCLUSION

Japan's historical susceptibility to economic disruptions has led it to focus on reducing its import dependency and shielding itself from external shocks. As a result, the Japanese economy is set to experience significant growth and development in the high-tech and renewable energy sectors, providing investors with vast opportunities. Significant investments have been made in nuclear, solar and wind power, as Japan looks to decarbonize and reduce its reliance on energy imports. Additionally, increased regulatory standards have created safeguards for foreign investors who seek to conduct business in Japan. The current devalued yen also offers foreign investors an affordable opportunity to enter the Japanese market. As Japan continues to implement its near-shoring strategy, its investments in South and South-East Asia provide for significant opportunities as the region continues to experience serious economic growth.

However, slow economic growth and demographic challenges are expected to persist in the short and medium term. The current political landscape signals instability that warrants close attention for investors, as a shift in government could impact key policies and the investment environment. Additionally, significant costs of conducting business and a historical reluctance to embrace inward FDI remain a key barrier to entry.

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