The Political Economy of National Security: Perspectives from the United States, Japan, Korea, and China

By Stephan Haggard

In the last decade, the trade policy agenda has shifted with remarkable rapidity. The high Cold War was accompanied by a strategic embargo on the Soviet Union and China. Detente loosened those restraints on trade and investment as engagement was seen as advancing broader political objectives with both countries. For most of the postwar period, the politics of trade centered largely on writing new trade rules—multilaterally, regionally and in bilateral free trade agreements—and negotiating how barriers to closer integration would be reduced. The agenda of such negotiations naturally shifted over time, moving from a focus on trade in goods to a variety of new issues: trade in services, intellectual property, digital trade, and the complex of issues surrounding foreign direct investment. And these negotiations were not without conflict. American protectionism and unilateral trade measures tested relations with alliance partners, and particularly in Asia. But outside of specialized regimes dealing with export controls and scattered use of sanctions for targeted purposes, security calculations were largely implicit. An open world economy, buttressed by multilateral institutions, was seen as advancing US grand strategy in Europe, in East Asia and with the developing world more generally.

Such assumptions are increasingly qualified. More and more, the trade policy agenda not only intersects with security issues but is driven by them. No one factor can explain this change; many are at work. The weakening of multilateralism is clearly one. Momentum toward liberalization has long shifted from the WTO to regional and bilateral agreements where geostrategic calculations are likely to play a more significant role. Political tolerance for greater exposure to trade has also clearly declined in the United States, permitting other calculations to gain more weight. But there can be little question that the animating factor in the new political economy of national security is not only China's rise, but the fact that its economy has not evolved in the market-oriented direction that had been hoped. China is not only an

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emerging power with increasingly expansive security ambitions, but one with a statist economic system fundamentally at variance with the norms on which the postwar trading regime was built.

This collection of essays provides insight into the political economy of national security through four national lenses: the United States, its two Northeast Asian treaty allies Japan and Korea and China. For the United States, the new focus on the political economy of national security is clearly driven by China, the decision to engage in strategic competition, and the domestic policy debates—to some extent partisan—on what such a strategy should entail. For Japan and Korea, the calculations are equally if not more complex. The U.S. embrace of an Indo-Pacific strategy rests on strengthening relations with allies and partners. Tokyo and Seoul must not only manage their alliances with the United States but balance stakes they have in their economic relationship with China.

China's perspective, too, requires a strategic lens. We are prone to think of China as pursuing a policy course dictated by the security preoccupations of the leadership, and Xi Jinping in particular. However, China faces its own political and economic constraints, particularly those arising from an economic slowdown that is structural as well as cyclical. Moreover, decoupling across the Pacific is no more realistic for Beijing than it is for Washington.

Before we can tackle these distinctive national positions, however, we need a clearer sense of the policy agenda: how, precisely, trade and investment intersect with national security concerns. There are five distinct ways in which they do so, each raising somewhat different policy and political concerns. First is the extent to which the United States is politically capable of sustaining economic commitments that support its Indo-Pacific strategy. A second cluster of issues arises around the growing use of economic leverage to achieve political objectives – the weaponization of interdependence – and simultaneous efforts to limit such leverage. These countermoves include increasing the resilience of supply chains but also calls for greater self-sufficiency. These concerns are common across all four countries, and even mirror one another in predictable ways. A third somewhat distinct objective springs from the logic of denial that motivated the Cold War strategic embargo, although in notably shallower form. How do the United States and its allies limit exports and investments that increase the capabilities of rivals and competitors? A fourth issue is the appropriateness of industrial policy: the extent to which a wider state role is seen as necessary to maintain economic competitiveness in emerging technologies or to anchor national capabilities more broadly.

Finally, we need to consider international institutional questions: the frameworks that provide rules underneath strategic competition. Should the United States, its allies—and China for that matter—seek to revive existing multilateral frameworks? Or are altogether new understandings in order to manage the challenges that China poses?

The Political Economy of National Security

The debate about economics and security has been muddied by the fact that countries are simultaneously juggling multiple policy objectives that do not necessarily align into coherent policy packages. Separating these out, and underlining the policy challenges associated with different objectives, underscores the complexity of the economics and security agenda.

A first question that is particularly pressing for the United States centers on the political tolerance for increasing economic integration and the persistent challenges of protectionism. From the end of World War II well into the 1970s, U.S. imports as a share of GDP were less than five percent. Continuing trade liberalization and the entry of Japan, the East Asian newly industrializing countries into global markets and ultimately China pushed this up to nearly 18 percent by the time of the global financial crisis when the degree of economic openness stalled and even fell back slightly. Over this long period of deepening international exposure, current account deficits widened and employment in manufacturing underwent a secular decline, falling from over 25 percent in 1970 to around 10 percent today. Whether these developments are causally related is one of the great debates of our time, but one thing is increasingly clear. Economic analysis increasingly acknowledges that while the aggregate effects of trade remain positive, its distributional consequences are real.[1] These distributional costs of trade have become a focus of both political parties; indeed, the Republican party now appears more inward looking than its Democratic counterpart. Nonetheless, there is a growing concern in both parties with economic security defined most fundamentally in terms of the well-being of disadvantaged constituents.

Although not a central focus of the papers in this collection, the political economy of protectionism hovers over the security debate. Domestic politics impinges on the capacity of the United States to exercise leadership in the Indo-Pacific, visible in the inability of either political party to follow through on the Trans-Pacific Partnership up through the difficulties the Biden administration faced at the 2023 APEC summit over the Indo-Pacific Economic Framework.[2] At the same time, "security" has been invoked in support of trade actions—with respect to steel, aluminum, and even autos—which do not appear to have any clear national security rationale, and may indeed harm the very alliance partners we are seeking to corral.

The second theme that runs through all four papers is what Farrell and Newman have called the weaponization of interdependence.[3] This agenda is wide-ranging, and in the United States has taken a variety of forms: from the use of trade policy instruments to generate leverage—most notably in the Trump administration's trade war—through the increasing attachment to sanctions as a foreign policy tool.[4] The use of these tools has been accompanied by a well-known debate about whether such sanctions "work" and what it means for them to work. Yet we are also seeing growing concern that such instruments may be subject to declining marginal returns. Target countries respond to such policies by diversifying, pursuing self-reliance and exploiting the massive international underground economy that has emerged in part to skirt sanctions efforts.[5]

With respect to China's behavior, the debate has focused around "economic coercion," and has now swept up a variety of U.S. allies and partners: Korea around the deployment of THAAD, the Philippines around South China Sea claims, Australia for its temerity in challenging China's COVID narratives, and European countries around their human rights preoccupations.[6] As with critics of the U.S. use of these tools, China analysts are arguing whether aggressive economic diplomacy has had the effect of attracting support—as some Chinese scholarsappeared to think—or whether it fuels blowback and new anti-coercion instruments.[7]

However, it is important to underscore that the weaponization of interdependence has two sides. On the one hand are efforts on the part of both the United States and China to manipulate their very extensive trade ties for leverage. The United States exploits its unique networks and capabilities, for example with respect to financial clearing and semiconductor design; China relies on the substantial dependence it has quite purposefully built among its trading partners.

But on the other hand, are the attempts—and again, on both sides--to reduce those vulnerabilities. A significant component of the current debate about economics and security centers on the means for accomplishing this objective, including through supply chain resilience. Multinational enterprises have always had to manage risk in the design of their international production networks, for example through diversification and make-buy decisions. What is new is the focus on political as well as economic risks. Among the strategies in play are encouraging geographical diversification on the part of national firms—evident in the advocacy of China+1 strategies—onshoring (which is in effect import-substitution) or "friendshoring" through cooperation with allies.[8]

Nor is China standing still with respect to reducing its external risk. The theory of "dual circulation" could have been read as a badly-needed effort to rebalance the Chinese growth model towards increasing domestic consumption. Over time, however, it has devolved into an effort to sustain export growth while simultaneously limiting imports and relying to a greater extent on domestic production. More broadly, the entire Belt and Road Initiative (BRI) could be seen as a grand strategic counterpart to the U.S. focus on "allies and partners." As with the U.S. Indo-Pacific strategy and the efforts to "friendshore," China has pursued its own "neighborhood diplomacy," an early initiative of the Xi Jinping administration that is now ten years on.[9]

The policy issues with respect to such "de-risking" center on how to define which risks are tolerable so that desirable economic relationships are sustained, and underlying rules do not erode. For example, the Biden administration has sought to focus its efforts on supply-chain resilience on a handful of particular sectors and related objectives: public health and biological preparedness; information and communications technology, including semiconductors; energy, encompassing green transition objectives; and critical minerals and materials.[10] Nonetheless, the International Trade Administration identified no fewer than 2400 "critical" goods and materials under this nominally focused strategy.

A third strand of the economics/security tangle centers on export and investment controls, the objective of which is not leverage but denial: to prevent strategic competitors from acquiring particular capabilities. Andrea Viski's contribution on U.S. policy traces the evolution of such controls in the United States, which had their conceptual origins in the wide-ranging strategic embargos of the high Cold War. Subsequently, multilateral export control regimes narrowed the product menu to so-called dual-use goods, services and technologies and tied controls to military end-uses. For example, the product specifications hammered out in the Nuclear Suppliers Group identified inputs that could lead to the generation of fissile material or the production of nuclear weapons and committed members of the group to initiate appropriate licensing over those products.

As Veski also shows, however, the debate about export controls underwent a significant shift over the last five years. Of particular importance were the passage of the Export Control Reform Act (ECRA) and the Foreign Investment Risk Review

Modernization Act (FIRRMA) in 2018, which updated the rules governing the Committee on Foreign Investment in the United States (CFIUS). ECRA still focused on core technologies that can pose national security threats to the United States, but also introduced language underlining the importance of maintaining and even developing capabilities in strategic or foundational goods.

In describing the policy process, it is worthwhile to note the distinction between export controls and the investment screening process, both with respect to incoming and outgoing investment. In the end, however, the motives of these controls are the same: to assure that technologies are not weaponized. Although not discussed in detail in these papers, these motives will increasingly extend to negotiations—and protective actions--with respect to intellectual property as well. Complaints about the theft of intellectual property are by no means limited to purely commercial concerns but increasingly focus on theft of dual-use and military technologies, including through cyberspace.[11]

The main challenge for achieving these denial objectives is akin to the sanctions enforcement problem: how to control leakage given the incentives controls create for diversion. Let me cite an example that has attracted scrutiny in the economic press.[12] We can write a rule that denies a Chinese entity such as iFlytek, a partly state-owned firm, access to Nvidia A100 chips. But will such control incentivize Nvidia to supply chips just shy of technical thresholds or iFlytek to purchase such chips on gray markets? iFlytek can also lease cloud computing services that run on Nvidia chips. Do we regulate or even restrict cloud services?

The answer is not sanctions nihilism: controls are always porous to some extent and raising costs to illicit purchasers might itself be a partial policy win. But sanctions and export controls do incentivize a growing parallel universe of trade, investment and finance. Particularly given the changed geostrategic environment, China, Russia, North Korea, and Iran tacitly cooperate by turning a blind eye to export controls or even purposefully assisting firms in circumventing them. At a minimum, effective controls require coordination among allies. Yet they may also rest on extraterritorial tools such as the Foreign Direct Product Rule—which effectively grants the United States the power to control exports that embody certain American technologies--or the imposition of secondary sanctions on uncooperative rivals.

A fourth basket of issues centers on a significant intellectual shift: a reconsideration of the merits of industrial policy. East Asia was a pioneer in open-economy industrial policy, an approach that combined selective support for manufacturing with broadly export-oriented growth strategies.[13] This developmental state approach fell out of favor as economies became more open—in part because of foreign pressure—and the costs of industrial policy were seen to outweigh the benefits. More recently, however, industrial policy has witnessed a renaissance among the advanced industrial states.[14] The Biden administration's Inflation Reduction (IRA) and Chips and Science Acts (CHIPS Act) increased public investment in green energy, semiconductor research and even production. As June Park shows in her contribution on Korea's future industries, U.S. trading partners have followed suit, not simply by emulation but out of competitive concerns. Audrye Wong shows that China's commitment to industrial policy has followed a pattern quite different from Japan and Korea. Rather than industrial policy receding in the face of continued market-oriented reforms, China has embarked on a giant U-turn, moving away from its commitment to reform and opening and toward greater state and party intervention in the economy.[15]

It is beyond this collection of essays to debate the merits of such interventions, and the authors take somewhat different views. Can public investments be efficient or are they necessarily tainted by rent-seeking or government error? How can industrial policies be designed to incentivize firms to greater innovation and productivity? However, two policy points are worth underlining about the industrial policy agenda. The first is that these efforts are increasingly cloaked in a national security rationale. Nowhere is this more clear than in China where securitization and "civil military fusion" have become defining characteristics of the country's national security state.[16] However, this is true of recent efforts in the United States, Japan and Korea as well. The second question raised by the resurgence of industrial policy is how to manage the conflicts such policies can generate. Although many policies are relevant here, the proliferation of subsidies, the tendency for them to generate mimicry and the badly fraying WTO subsidies regime deserve mention.[17] Although these issues are most clearly in evidence with respect to the U.S.-China trade war and Europe's growing attention to the challenge, they have also arisen among the advanced industrial states as well.

The possibility that strategic competition will generate economic races-to-the-bottom segues naturally to the final cluster of issues where economics and security intersect: the role played by international and regional organizations and the effort to craft rules of the road. China's emergence on the world economic stage was capped by its entry into the WTO, which was seen as placing important restraints on Chinese economic policy. Since that time, the WTO has suffered a long slow decline, first through the inability to negotiate a conclusion to the long-running Doha Round and more recently because of debilitating conflicts over the dispute settlement process. WTO commitments remain intact, but its inability to manage emergent trade policy conflicts with China is increasingly clear and trade policy action has long shifted to regional, plurilateral and bilateral agreements. The rise of national security considerations not only makes it more likely that such groupings will play a central role in world trade, but also imbues them with a competitive quality.

Will Asian-only trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) shape trade relations in the Indo-Pacific, or will initiatives spearheaded by the advanced industrial states carve out meaningful roles: the Trans-Pacific Partnership (TPP) and its successor the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Quad, or the Indo-Pacific Economic Framework (IPEF)? Do Chinese-led initiatives such as BRI provide global public goods or do they embody competing economic norms and security ties that are inimical to Western interests? Not surprisingly, these questions about appropriate regional frameworks come up in all four of the contributions to this symposium. Of particular interest is whether and how U.S. allies in the region might cooperate on the expansive security agenda just outlined: to anchor alliance relations in expanded economic ties; to exercise leverage collectively; to coordinate around export controls; and to foster innovation.[18]

National Perspectives I: The United States and Its Allies

This framework helps locate the four papers that follow and places them in a larger context. Andrea Viski grounds her approach to the United States around the evolution of export controls. She notes the origins of these policies in the multilateral export control regimes and UN Security Council Resolution 1540, which mandated controls to limit proliferation risk in the wake of 9/11. She then focuses on the groundbreaking statutory changes in 2018 that reformed the export control process and delineated emerging technologies that warranted scrutiny and oversight. She argues these new laws broke the link to specific military end-uses since the ultimate value of such technologies for military purposes "is, in many cases, unknown, vague or in flux." Clearly, security considerations were paramount, most notably in the targeted export controls rolled out by the Biden administration in October 2022 and October 2023.[19]

A distinctive feature of Viski's contribution is her focus on the fifth agenda outlined above: not simply on export controls but the challenges of coordination. She outlines how the United States has been forced to think in terms of multilateral frameworks to accomplish export control objectives because of the challenges of leakage, and not only from hostile actors but from allies as well. Among the initiatives she outlines are the U.S.-EU Trade and Technology

Council (TTC), whose stated objective includes "strengthening our technological and industrial leadership, boosting innovation, and protecting and promoting critical and emerging technologies and infrastructure."[20] In the Asia-Pacific, these efforts have centered more on supply-chain resilience through the Indo-Pacific Economic Framework. However, Viski documents the aggressive U.S. diplomacy to align allies with its export control agenda, in part through the shadow of U.S. extraterritorial reach provided by the Foreign Direct Product rules.[21]

Kazuto Suzuki focuses his attention on Japan's effort to pursue a "derisking" strategy, and particularly the passage of the Economic Security Promotion Act in May 2022. He emphasizes that Japan's derisking strategy is not only or even primarily about economic considerations, such as how supply chains might be disrupted by exogenous shocks. Rather, it is about politics, "aimed at reducing the risk of states trying to exert political pressure by using their economic relationships as power between states, in other words, by stopping trade in certain goods as a means of international politics." The introduction of this agenda is surprisingly recent in Japan, with heightened concern emerging in the wake of conflicts around the Senkaku/Diaoyu islands and the Chinese threat to retaliate by limiting rare earth exports.

Suzuki makes an interesting conceptual contribution by noting how derisking resembles deterrence, which in turn can be achieved by either defense—through reducing dependence—but also through punishment or the leverage strategies outlined above. The legislation defines supply-chain resilience explicitly in terms of avoiding overdependence on particular suppliers but widens the concept to include protection of critical infrastructure—expansively defined—and critical information that could have adverse security consequences. As with the paper on the United States, the contribution on Japan closes with important institutional issues. Coordination is one way to lower the risk of coercion, and Suzuki notes the costs of a WTO which has been missing in action. Suzuki also underlines the discussion initiated by the EU around "Anti-Coercion Instruments" that are of interest to middle and smaller powers facing constraints from China.

June Park's analysis of the Korean case focuses on future industries, with an emphasis on semiconductors, and thus provides a compelling example of industrial policy as national security policy. Even more than in the Japanese case, Park portrays Korean developments as a response to pressures within the alliance. These include efforts on the part of the United States to secure greater inward investment in the semiconductor industry in the early Biden administration and its more systematic pursuit of industrial policy in the IRA and CHIPS Act. Both pieces of legislation generated conflict with Korea by making subsidies conditional on domestic production in the United States and thus diverting Korean investment away from the home market or other regional partners. She walks through three pieces of legislation in some detail: the KChips Act, which focused on tax breaks to the industry, the Act on Protection of Industrial Technology (ITA), intended in part to prevent leakage of intellectual property, and a more recent and expansive Advanced Industries Act which targeted innovation in sectors ranging from displays, to batteries, biopharmaceuticals, nuclear power and robotics. She argues that while the Advanced Industries Act was targeted more narrowly on the stability of supply chains the ITA covered technologies that may have a more foundational impact on growth and national security. A key takeaway from the Korean case study is not only that U.S. policy can generate conflicts with allies, but also how they may respond with industrial policies of their own. The question looming over this case study is whether the advantages of greater resilience and capacity outweigh the potential for inter-allied competition and protection, and how those gains might be realized collectively through initiatives such as the Chip-4 alliance among the United States, Japan, Korea and Taiwan.

National Perspectives II: China under Xi Jinping

Audrye Wong's contribution on China had the most daunting task because of the extent to which economics and security are interwoven in Chinese political narratives. Following Mao's death and the initiation of reform and opening under Deng, the Chinese leadership was preoccupied with buffering potential shocks associated with closer economic integration. Wong shows how those have concerns continued in Beijing's preoccupation with energy dependence and financial integration, about which the leadership remains extraordinarily cautious. Wong notes that Chinese discussions of economic security during the reform era were also always linked to national security in a broader sense. Chinese writings—drawing on long traditions of "self-strengthening" --emphasized that national power, including military capabilities, rested on an economic foundation.

At the same time, she underlines that Chinese commentary took a nuanced approach which recognized the strategic value of closer economic integration with the world economy. Such integration not only provided economic benefits but allowed China to capitalize on its rising stature, for example by increasing its leverage with trading partners. The core puzzle for China analysts is why the phase of optimism--in which economic reform, rapid growth and rising international status went together—devolved into a much darker and more threatening picture of the international landscape.

The United States is certainly one factor. Starting with Hu Jintao's turn to industrial policy, but accelerating under Xi Jinping, China's notion of economic security has been driven by the perception that the United States is pursuing a strategy of economic containment. According to Wong, this turn toward securitization has required some subtle but important doctrinal changes, away from the "development-first" policies of the Jiang Zemin era. In 2014, Xi Jinping signaled the new direction with his Comprehensive National Security Concept, which would take "security as the purpose, political security as the basis, and economic security as the foundation." The integrated development-security approach reached its apogee during the Fifth Plenum of the 19th Central Committee in October 2020, and is now linked to wider political objectives captured in catchwords such as "the strategic rejuvenation of the Chinese people with changes unseen in a century." Yet it is hard to see these developments as emanating from the United States alone; domestic concerns about political security also play a considerable role as well.

Wong identifies a number of components of the new strategy, some of which are well-known and others less so. The explicit turn to a new industrial policy, captured in "Made in China 2025" initiatives, marks a fundamental shift in government-business relations that has affected perceptions of China risk. In addition to the challenges posed by the theft of intellectual property,the massive subsidization of strategic sectors, and surplus capacity the turn to industrial policy has been accompanied by attacks on prominent Chinese firms that augur poorly for the perceptions of foreign investors. The punitive actions taken during the COVID-era against private firms also reflect a deeper concern about the ability of the Chinese private sector to exercise political leverage over the regime.

On the external front, the new industrial policy is explicitly motivated by concerns about the ability of the United States to strangle China's further economic advance through the chokehold it exercises over a number of key technologies, most notably semi-conductor design.[22] In the 14th Five Year Plan (2021-2025), the regime identified four broad categories of risk: those associated with industrial supply chains, food and agriculture, energy and resources, and the financial system. Wong shows, however, how purely commercial motives—staying internationally competitive—are tightly coupled to wider security objectives through "civil military fusion."

A particularly interesting finding from Wong's analysis is China's explicit use of trade ties for the purpose of generating leverage. Wong points out how China has self-consciously engaged in strategies of "deep coupling," ultimately exploited in the policies characterized by the United States and its allies as "economic coercion." Another interesting finding of Wong's research is the recent effort by the government to institutionalize the new national security agenda through a variety of laws. These include, among others, revisions of foreign trade and investment laws, the creation of an Unreliable Entity List, China's own Export Control Law, Rules on Counteracting Unjustified Extra-Territorial Application of Foreign legislation and an Anti-Foreign Sanctions Law. One possible purpose of these laws: to signal Chinese resolve and to provide policy instruments for deterring "anti-China" actions.

Concluding Thoughts

Segmenting the economics and security agenda is important because different objectives may collide. At the most encompassing level, the strategic as well as economic gains that the United States, its allies and China reap from closer economic integration are put at risk by the restraints on trade and investment that are motivated by security concerns. Efforts to exercise leverage, impose sanctions for political ends and tighten export and investment controls all throw sand in the wheels of global commerce and require continual reassessment.

But the costs of these measures are not simply one-off; they can set in train dynamic processes with unintended consequences. To cite but three examples, U.S. efforts to impose multilateral and bilateral sanctions against adversaries such as North Korea and Russia have contributed to a thriving global underground economy of illicit activities and sanctions evasion, facilitated in part by innovations such as cryptocurrency. Even among allies, sanctions can have perverse effects. Japan's effort to signal displeasure in an ongoing history war with Korea had the unintended effect of pushing South Korea to substitute for Japanese imports.[23] And U.S. policies to constrain Chinese trade practices, although warranted, appear to have pushed Xi Jinping to double-down on his industrial policy bets. The trade/security agenda is here to stay, but always requires critical scrutiny; these papers all contribute to that effort.

Endnotes

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