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POLICY MEMO

US-Japan Cooperation in a Changing Investment Environment

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Executive Summary

Tokyo passed a law in May that expands its authorities to review more types of foreign investments, including those from holding companies and indirect investors, for national security concerns. The Japanese government also passed legislation to create its own version of the Office of the Director of National Intelligence. It will include the new intelligence-gathering and interagency coordinating effort in its future national security investment review system as the country tries to adopt an investment review system more like that of the United States. Having a robust investment review system is more important now than ever as Beijing expands its oversight of outbound foreign investments and extraterritorial activities, such as American and Japanese investment screening. As investment opportunities for the US and Japan expand, both countries will need to continue to support each other's regulatory systems and national security interests.

Background

Being an open economy that welcomes inward investments, the United States has become the largest destination for foreign direct investment (FDI), with Japan being one of its largest sources of FDI.[1] Japan, however, has struggled to attract significant amounts of foreign investment and maintains one of the lowest inward FDI-to-GDP ratios among major economies.[2] Several factors contribute to this outcome, including Japan's economic health, exchange rates, interest rates, and investment environment.

New leaders in both countries are encouraging more foreign investment. For example, the Trump administration has used tariffs on traded goods to encourage more FDI in domestic manufacturing, and this led to a large investment agreement between Washington and Tokyo.[3] Meanwhile, the government of Japan has set a goal to increase its inward FDI position to JPY 150 trillion by the end of 2030, more than doubling the

JPY 58.5 trillion FDI it held in 2025. To help reach this goal, it has been using its overseas offices to connect with potential investors.[4]

The challenge for American and Japanese officials is that not all foreign investments are equally effective at boosting an economy. Many cross-border investments come from investors who are simply making benign purchases of securities in the hope of finding financial opportunity. However, some investments can put American and Japanese national security at risk. Government officials have to screen out foreign investments that pose a threat to national security while still maintaining an open investment environment that allows the economy to thrive. More investments generally offer more opportunities but also higher risk.

To prepare for this increase in risk, Tokyo has recently updated its foreign investment review system. It hopes to make its review system more like the Committee on Foreign Investment in the United States (CFIUS), which also reviews foreign investments for national security concerns.

FEFTA Amendment

The Foreign Exchange and Foreign Trade Act (FEFTA) is the legal framework by which the government of Japan—specifically the Ministry of Finance (MOF) and the Ministry of Economy, Trade, and Industry (METI)—monitors cross-border transactions, including foreign investments.[5] Which investments regulators will review under FEFTA depends on a number of factors, including whether the investment is in a private or public company, the structures of the investment and the investing entity, the number of shares being acquired, and the investor's eligibility for exemptions.[6] The level of scrutiny a review receives also depends on whether the investment is in a sector that the government has designated as sensitive.[7]

Tokyo regularly updates these rules for reviewing foreign investments. On May 29, Japan's parliament passed an amendment that expands the government's authorities under FEFTA while encouraging greater interagency information sharing. The amendment has the following effects:

- **Expands what entities and activities require review.** Review under FEFTA may now include overseas investors, such as foreign holding companies, that have investments in Japan's designated and core designated sectors.[8] Any attempt to acquire more than 50 percent of a holding company's voting rights can come under review. Proxy investors and indirect investments are now also covered. This includes those in Japan that are investing on behalf of a foreign entity.
- **Increases mitigation efforts.** Mitigation agreements allow riskier investments to proceed so that an investor does not have to abandon an opportunity. To expedite the review process, the amendment allows foreign investors to propose self-mitigation measures that would limit their involvement in the management of the Japanese investee.
- **Increases transparency into other investments.** Because FEFTA does not have the authority to review all investments, the amendment expands the government's oversight and allows it to seek information from foreign investments in non-designated sectors when a change internationally could affect Japan's national security.
- **Encourages greater cross-ministerial coordination.** Such coordination is rare for Japan's often stove-piped bureaucracy, but MOF and METI must now seek the opinions of the prime minister, minister of foreign affairs, and head of any other relevant agency when reviewing investments. This arrangement is similar to the larger composition of CFIUS, which permanently includes nine federal departments and agencies and includes one additional department on a case-by-case basis.[9] CFIUS also consults with a dozen other US agencies and intelligence entities.

The cross-ministerial Japan Foreign Investment Committee held its inaugural meeting at the prime minister's office on June 29.[10] And while the amendment does not specify this addition, future investment review meetings will also include the opinions of Japan's soon-to-be-created National Intelligence Council (NIC) and National Intelligence Bureau (NIB). [11]

In addition to the amendment, Japan's government passed a new law on May 27 that will create the NIC and position it within the office of the prime minister, who will lead the new council.[12] The NIB will be part of the cabinet secretariat's office, and the equivalent to a director of national intelligence will lead it. The introduction of the new NIC and NIB will elevate Japan's intelligence sharing and cross-agency coordination. It will also assist Japan's effort to develop an investment review similar to CFIUS, which includes the US director of national intelligence as a non-voting, ex officio member.

Changing Investment Environment

The amendment is just one of Japan's recent efforts to align more closely with American standards for reviewing investments based on national security concerns while responding to a changing investment environment.

China Lawfare

In May 2025, Tokyo prioritized updating its rules for reviewing foreign investments to reflect Beijing's growing influence in the Chinese private sector.[13] It introduced new regulations that expanded FEFTA's authorities to cover investors that must cooperate with foreign governments that collect information related to Japan's national security. For example, the new authorities would allow Japan to review investments from companies in China and Hong Kong, which have to support Beijing's intelligence efforts due to the country's National Intelligence Law (2017) and Cybersecurity Law (2017).

More recently, the People's Republic of China (PRC) announced new regulations covering investments leaving China, or outbound investments.[14] While Beijing already regulates such investments, this new rule elevates the oversight to the PRC's more politically active State Council. This body will now ensure that Chinese investments align closely with the PRC's political interests, such as its One Belt, One Road initiative.

The State Council recently announced that its oversight responsibilities extend to extraterritorial regulations, which adds to the state's growing influence over business compliance efforts. Similar to its anti-sanctions law,[15] extraterritorial regulations could punish entities in China that adhere to foreign laws the State Council doesn't agree with—like Japanese and American investment screening. These new regulations put companies in a difficult position as they have to comply with China's domestic rules and foreign laws.[16]

This PRC council can impose punitive measures under a number of circumstances: if a foreign law (such as Japan's FEFTA) endangers China's national sovereignty, security, or development interests; if the foreign law harms the rights or interests of any Chinese person or organization; or if the council deems the measures necessary for any other reason. Such punishments include restricting visas, seizing property, prohibiting commerce, applying fines, and any other form of punishment it decides. This possibility complicates matters for Chinese investors hoping to invest in Japan or the US, especially if the State Council doesn't agree with foreign investment mitigation agreements.

These recent regulations expand the PRC's legal tool kit while foreshadowing the potential for lawfare between the communist country and open markets like Japan and the US. The announcements increase the risk that foreign companies and their Chinese partners might face when the PRC decides that overseas investments oppose China's national image or public interest.

US-China Board of Investment

In May, US and PRC officials agreed to establish a board of investment to discuss investment-related issues.[17] The board has yet to be created, but Treasury Secretary Scott Bessent and his counterpart in Beijing—Vice Premier He Lifeng, who is also a senior member of the PRC's State Council—will likely lead the high-level dialogue.

No evidence suggests that the new board of investment will influence the CFIUS process in any way. However, it signals that new Chinese investment is welcomed in the US. As the board meets and Chinese investors receive approval, Tokyo will likely want to know what new standard Washington is setting for Chinese investments. Secretary Bessent will likewise need to communicate with his counterpart in Tokyo, Minister of Finance Satsuki Katayama.

Japan's Demographics

In addition to the changing external investment environment, Japanese officials worry about how a rapidly aging society might affect the country's domestic investment environment. They're particularly concerned about the future of Japan's small and medium-sized enterprises (SMEs), especially as more of these businesses lack a clear successor. The annual number of SME closures has increased by 13 percent compared to just 10 years ago.[18]

Japan's aging society has also put pressure on SME owners to stay in business for longer. Their average age when they sell their business has increased to 71.5 years old. With more than half of Japan's SMEs now owned by someone over age 60, the next decade will see a significant shift in the ownership of Japan's 3 million SMEs. Japan risks losing a good number of these companies forever unless it can find a solution.

Japan is already seeing a steady increase in mergers and acquisitions (M&A) activity involving foreign investment.[19] Japanese officials are mostly concerned when a foreign entity may merge with or acquire an SME in one of Japan's sensitive industries. While most M&A activity is between Japanese-owned companies, the volume of foreign M&A will likely continue to grow. Likewise, the government should welcome American M&A in Japan to offset some of the losses associated with Japan's aging society.

Recommendations

Officials in the US and Japan understand the importance of balancing competing national interests. An open investment environment invites financial opportunity but also increases national security risks. Both governments want to make sure companies feel confident that they can continue to invest without undue scrutiny.

Japan's effort to emulate America's investment screening system is admirable. Its new system will differ from America's, but the effort helps close gaps that bad actors might otherwise exploit. As American and Japanese officials work together on a robust investment screening system that adapts to the changing investment environment, officials should consider the following possible reforms.

Designate Japanese investments as "excepted investments" to build investor confidence. Right now, CFIUS considers only Australia, Canada, New Zealand, and the United Kingdom as so-called excepted foreign states due to years of intelligence sharing among these countries.[20] Qualified investors from excepted foreign states can expedite parts of the CFIUS review. [21] As Japan establishes its own intelligence agency, which will coordinate closely with its American counterpart, the US should consider adding Japan as an excepted foreign state for purposes of investment screening.[22] Investors from Japan invest more in the US than from any other country. This change will help increase the timeliness of Japanese investments that continue to flow into the US while reducing the workload of America's investment screening workforce.

Implement FEFTA prioritization for American investments. The FEFTA process can be quite opaque to the companies involved. Japanese officials have worked to ensure the government processes reviews more quickly, but concerns about timeliness remain. They should establish a standard to expedite the review of American investments. Because the US is Japan's only treaty ally, American investments should receive special attention.

Encourage an investment screening workforce exchange. Constant changes to American and Japanese investment regulations require greater cross-country coordination, including the sharing of best practices. Efforts are already underway in Congress to increase State Department support for foreign partners' investment screening processes.[23] Meanwhile, the Treasury Department has undertaken innovative measures to expedite reviews by creating a Known Investor Program and "shot clock" initiative.[24] Japanese officials could emulate these efforts in the future as more American investment enters Japan. Not only does the United States need to help its allies and partners establish robust screening systems, but it also needs to learn how these countries are likewise adjusting to their local investment environments.

Adjust CFIUS composition. Just as Japan considers adding more bureaucracy to its investment review process, the US should consider whether the current bureaucratic participation in its investment review process is appropriate. US government officials have been exploring innovative ways to meet the high demand for investing in the US. In addition to these efforts, the White House should consider an executive order to move the Office of Science and Technology Policy and the Office of the US Trade Representative from voting members of CFIUS to the same participation level as the National Security Council. This would allow CFIUS to reach a faster consensus during the review process.

Conclusion

The recent amendment to FEFTA is a modest but necessary step toward modernizing Japan's investment screening system. While Japan's investment system is unlike America's, it is likely one of the more robust investment review systems in the world. Maintaining a healthy and secure investment environment between the US and Japan is now more important than ever as the two countries continue to facilitate hundreds of billions' worth of cross-border investments. The US and Japan should continue close coordination of regulatory reforms and information sharing to meet the challenges of an ever-changing investment environment.

Abbreviations

CFIUS: Committee on Foreign Investment in the United States

FDI: foreign direct investment

FEFTA: Foreign Exchange and Foreign Trade Act

JPY: Japanese yen

M&A: mergers and acquisitions

METI: Ministry of Economy, Trade and Industry

MOF: Ministry of Finance

NIB: National Intelligence Bureau

NIC: National Intelligence Council

PRC: People's Republic of China

SME: small and medium-sized enterprise

Endnotes

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