

GEOPOLITICAL RISK OBSERVATORY

Japan

An overview

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GRO Country Profile: Japan

GRO Country Profiles are neither extensive analyses nor news updates. Rather, they provide a general perspective on selected areas and issues, identifying a set of factors and variables that organizations should monitor in order to anticipate risks.

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Summary

- Japan is a stable parliamentary democracy under a constitutional monarchy. On 18 February 2026, the Diet designated Sanae Takaichi as prime minister, inaugurating her second cabinet and reinforcing expectations of policy continuity, institutional stability, and strong administrative capacity.
- Geopolitically, Japan remains anchored to the US alliance and G7 coordination while managing sustained strategic pressure from China and security risks from North Korea’s nuclear and missile capabilities. Its long-term policy direction prioritises stronger defence, economic security, supply-chain resilience, and protection of critical technologies amid heightened regional tensions.
- For business, the environment combines predictable institutions with a rising economic-security and compliance burden. Japan is tightening and centralising screening of sensitive foreign investment and technology exposure, increasing due diligence, documentation, and supply-chain assurance requirements for foreign firms operating in critical sectors.

Basic Parameters

Indicator	2020	Latest value
GDP (PPP, USD bn)	5,499.9	7,262.2 (2026 proj.)
Population (mn)	126.1	122.7 (2026 proj.)
Population under 25 (%)	21.4	20.3 (Mar. 2026)

Indicator	2020	Latest value
Population over 65 (%)	28.6	29.5 (Mar. 2026)
Urban population (%)	91.8	92.3 (2025)
Unemployment rate (%)	2.8	2.5 (2026 proj.)
Youth unemployment 15-24 (%)	4.7	3.9 (2025)
Consumer price index (CPI) inflation (% annual average)	0.0	2.2 (2026 proj.)
General government debt (% of GDP)	228.8	204.4 (2026 proj.)
Foreign direct investment (FDI) inward flows (USD mn)	11,768	14,321 (2025)

Sources: IMF – World Economic Outlook, April 2026 (GDP PPP, both 2020 and 2026 projection; population, unemployment and CPI inflation, 2026 projections); Statistics Bureau of Japan – 2020 Population Census, Labour Force Survey, Consumer Price Index and Population Estimates, August 2026 (2020 population, population structure, unemployment and CPI inflation; March 2026 final population estimates by age; under-25 shares calculated from official five-year age groups); World Bank – World Development Indicators (urban population, both 2020 and 2025); ILO – ILOSTAT (youth unemployment, modelled estimates, both 2020 and 2025); IMF – Fiscal Monitor, April 2026 (general government debt, both 2020 and 2026 projection); UNCTAD – World Investment Report 2026, Annex Table 1 (FDI inward flows, both 2020 and 2025).

Historical context

Japan emerged from the Second World War after its surrender in August 1945 and entered a US-led Allied occupation that lasted until 1952. The 1947 Constitution established the post-war order, defining the Emperor as the symbol of the State and embedding parliamentary democracy, civil liberties, and the renunciation of war under Article 9. The 1951 US-Japan Security Treaty, replaced in 1960 by the Treaty of Mutual Cooperation and Security, anchored Japan within the US-led Western security system.

From the mid-1950s, the Liberal Democratic Party became the dominant political force, while rapid industrialisation and export-led growth transformed Japan into a major global economy. Close security ties with Washington coexisted with expanding commercial relations across Asia. The reversion of Okinawa and normalisation of diplomatic relations with the People's Republic of China in 1972 broadened regional diplomacy, while the oil shocks exposed Japan's dependence on imported energy.

The collapse of the asset-price bubble in the early 1990s ushered in prolonged low growth, banking stress, deflation, and rising public debt. The Liberal Democratic Party lost national government in 1993 and again between 2009 and 2012, but the institutional system remained resilient. The 2011 Fukushima nuclear accident reshaped energy policy, while Shinzo Abe's return to office in 2012 combined economic stimulus with a more active security posture. The 2015 security legislation enabled a limited exercise of collective self-defence under defined conditions.

Regional security pressures subsequently accelerated Japan's shift towards a more active defence posture. In 2022, the Economic Security Promotion Act strengthened policy on critical supply chains, infrastructure, technologies, and sensitive patents. In December, Japan adopted a new National Security Strategy, National Defense Strategy, and Defense Buildup Program, committing to stronger defence capabilities, including counterstrike capabilities, while integrating economic security and supply-chain resilience into national strategy.

Institutional Set-Up and Structural Challenges

Japan is a unitary parliamentary democracy under a constitutional monarchy. Sovereignty resides with the people, while the Emperor is constitutionally defined as the symbol of the State and exercises no governing power. Executive authority rests with the Cabinet, which is collectively responsible to the bicameral National Diet, composed of the 465-member House of Representatives and the 248-member House of Councillors. Sanae Takaichi was designated prime minister on 18 February 2026 following a decisive general-election victory. The Liberal Democratic Party (LDP) holds 316 seats in the lower house and its coalition partner, the Japan Innovation Party (JIP), holds 36; the coalition remains short of a majority in the House of Councillors.

Political stability is high by comparative standards. The LDP remains the dominant political force, and the February 2026 election strengthened the government's lower-house position after a period of weaker majorities and leadership turnover. Political competition remains constitutional and leadership changes take place through established electoral and party mechanisms. The coalition's weaker position in the upper house still requires negotiation on some legislation, but sustained legislative paralysis is unlikely. Over the next twelve months, the probability of a domestic institutional shock materially disrupting business operations is low.

Governance standards are comparatively strong. Transparency International's 2025 Corruption Perceptions Index ranks Japan 18th globally with a score of 71/100, while the World Justice Project ranks the country 15th out of 143 jurisdictions in its 2025 Rule of Law Index. Businesses generally benefit from predictable enforcement, an independent judiciary, strong property-rights protection, and low official corruption. Weaknesses are concentrated in administrative complexity and transparency gaps. OECD analysis identifies multi-stage registration and licensing procedures, incomplete digital integration across government services, and limitations in one-stop

services for foreign investors. These constraints raise transaction costs but do not fundamentally undermine the reliability of the legal and institutional framework.

Japan has a diversified, advanced economy led by private enterprise, with internationally competitive manufacturing, automotive, machinery, electronics, financial, and technology sectors. The state nevertheless plays a more active strategic role through subsidies and industrial policies supporting semiconductors, digital technologies, defence-related capacity, supply-chain resilience, and the Green Transformation (GX). Population decline and rapid ageing are shrinking the labour force, generating persistent labour shortages and increasing pension, healthcare, and long-term-care expenditure. Productivity remains below the OECD average, while gross public debt is the highest in the OECD, limiting fiscal space as interest rates normalise. Inward foreign direct investment (FDI) also remains unusually low for an advanced economy, at around 5% of GDP, reflecting linguistic, administrative, and business-network barriers despite government efforts to attract foreign capital.

Internationally, Japan is anchored in the US alliance and G7 while pursuing a rules-based Indo-Pacific strategy through the Quadrilateral Security Dialogue (Quad), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and the Regional Comprehensive Economic Partnership (RCEP). It is not directly involved in an active interstate conflict, but remains exposed to tensions involving China, North Korea, Russia, and the Taiwan Strait. The United States and China each account for around one-fifth of Japanese goods exports, while Japan depends on imported energy and selected critical minerals, including significant reliance on Middle Eastern crude oil and Chinese supply chains. Economic security has therefore become increasingly integrated into domestic policy. The 2022 Economic Security Promotion Act, the June 2026 amendment of the Foreign Exchange and Foreign Trade Act, and the Japan Foreign Investment Committee strengthen oversight of critical supply chains, sensitive technologies, infrastructure, and foreign investment. The principal structural external risk is a medium-probability geoeconomic or regional-security shock affecting trade, energy, technology access, or strategic supply chains.

Business implications

Opportunities

Japan offers substantial opportunities for foreign investors through institutional stability, deep capital markets, advanced industrial capabilities, and government support for strategic investment. The government has raised its target for inward FDI stock to ¥120 trillion by 2030 and ¥150 trillion in the early 2030s, compared with ¥61 trillion at end-2025. Policy support targets digital transformation, green technologies, life sciences, advanced manufacturing, and sectors important for economic security. Japan's high-income market, sophisticated infrastructure,

skilled industrial base, and extensive trade-agreement network provide a stable platform for companies seeking domestic demand and wider Asian supply chains.

The strongest opportunities are concentrated in artificial intelligence (AI), semiconductors, automation, advanced materials, energy, and GX. Japan plans more than ¥10 trillion in public support for AI and semiconductors through fiscal year 2030, aiming to mobilise over ¥50 trillion in public and private investment. GX policy envisages more than ¥150 trillion of public-private investment over a decade, supported by about ¥20 trillion in transition bonds. Grids, storage, renewable generation, nuclear-related supply chains, energy efficiency, and industrial decarbonisation therefore offer opportunities alongside semiconductor manufacturing and advanced computing. Persistent labour shortages strengthen demand for robotics, industrial automation, digital services, and productivity-enhancing technologies, while partnerships with established Japanese manufacturers can provide market access.

Challenges

- *Security challenges:* Japan presents a low physical security risk for foreign businesses. There is no active domestic armed conflict or insurgency, terrorist violence is rare, and violent organised crime does not systematically disrupt commercial activity. Boryokudan groups remain active, including in illicit finance and occasional intimidation of businesses, but sustained law-enforcement pressure has significantly constrained their operational reach. The more material security challenges originate outside the domestic environment. Military tensions involving China, North Korea, Russia, and the Taiwan Strait create persistent contingency risks for shipping routes, energy imports, aviation, and strategic infrastructure, although Japan is not directly involved in an active interstate conflict. Cybersecurity represents a more immediate operational concern: the government identifies sophisticated and state-linked attacks against companies, government bodies, and critical infrastructure as a major national-security threat. Firms in finance, energy, manufacturing, logistics, and technology therefore require stronger business-continuity, data-protection, and cyber-resilience arrangements than Japan's very low levels of conventional violence alone would suggest.

Japan's security risk is assessed as Band 2 (low challenges).

- *Regulatory challenges:* Japan benefits from a generally transparent and rules-based regulatory framework, extensive trade agreements, and comparatively limited formal barriers to foreign investment. Nevertheless, administrative procedures remain more burdensome than the country's institutional quality would suggest. The OECD identifies complex business registration and licensing procedures, incomplete digital integration

across public authorities, and limitations in the coordination of one-stop services for foreign investors. Compliance requirements are also increasing in strategically sensitive sectors. Foreign investment in designated industries is subject to prior notification and national-security screening under the Foreign Exchange and Foreign Trade Act (FEFTA), while the June 2026 FEFTA amendment broadens the framework to address indirect investment, foreign-government influence, and security concerns extending beyond currently designated sectors. The creation of the Japan Foreign Investment Committee further strengthens interministerial scrutiny.

Economic-security policy adds a second layer of regulatory complexity. The Economic Security Promotion Act imposes requirements relating to critical supply chains, sensitive technologies, patents, and designated infrastructure, while export-control and technology-transfer rules require closer screening of counterparties and end uses. Foreign manufacturers also face external constraints affecting Japanese supply chains. Chinese restrictions on critical minerals and dual-use goods have already produced licensing delays and longer customs inspections for Japanese companies, while US tariff measures continue to affect export-oriented industries despite the bilateral tariff agreement. Japan's Green Transformation also introduces additional compliance requirements, including the full-scale emissions trading system from FY2026. These measures remain targeted rather than economy-wide, but firms operating in semiconductors, energy, advanced manufacturing, telecommunications, defence-related industries, and critical infrastructure face a materially higher documentation and due-diligence burden than businesses in less sensitive sectors.

Japan's regulatory risk is assessed as Band 2 (low challenges).

- **Governance challenges:** Governance remains one of Japan's strongest advantages for foreign businesses. The country scores 71/100 and ranks 18th globally in Transparency International's 2025 Corruption Perceptions Index, while the World Justice Project ranks Japan 15th out of 143 jurisdictions in its 2025 Rule of Law Index. Bribe demands from public officials are uncommon, courts operate independently in commercial matters, property rights are strongly protected, and foreign companies can generally rely on formal legal and administrative remedies. Political controversies and party-funding scandals periodically generate reputational concerns, but they have not translated into systemic discrimination against foreign businesses or broad deterioration in contract enforcement.

Public procurement represents a relative weakness within this otherwise strong framework. OECD analysis identifies a high incidence of single-bid and non-competitive procedures, fragmented procurement systems across different levels of government, and barriers that can reduce effective competition, particularly for new and foreign entrants. Language requirements, long-established supplier relationships, and differing local registration

procedures can also complicate access to public contracts. These factors increase transaction costs and make local partnerships valuable, but they are better understood as limitations in openness and administrative efficiency than as evidence of pervasive corruption or politically biased enforcement. Overall, the rule-of-law environment remains highly predictable by international standards.

Japan's governance risk is assessed as Band 1 (very low challenges).

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