

Basic Policy on Enhancing Defense Production and Technology Bases

(Summary)





Background and Rationale for Formulation

- The three strategic documents, formulated in December 2022, state “the defense production and technology bases are a virtually integral part of defense capability itself,” and mention the implementation of legislation for policies that need immediate responses to enhance these bases.
- For this purpose, the Government, at an ordinary Diet session in 2023, made a Cabinet decision and submitted a Bill on Enhancing Defense Production and Technology Bases (Cabinet Bill No. 20), and this was enacted as Act No. 54 of 2023 in June of the same year.
- This time, pursuant to Article 3 of the Act and for its appropriate and effective enforcement, the “Basic Policy on Enhancing Defense Production and Technology Bases” is formulated. In addition, the formulation of this Basic Policy, pursuant to the Act, newly provides the direction on maintaining and enhancing the bases for the future, replacing the “Strategy on Defense Production and Technological Bases” formulated in 2014.

○Act on Enhancing Defense Production and Technology Bases (2023 Act No. 54) Excerpt

Article 3 The Minister of Defense shall establish a Basic Policy on enhancing defense production and technology bases (hereinafter referred to as the “Basic Policy”).

2. The Basic Policy shall stipulate the following matters:

- (1) Basic matters concerning the security environment of the international community, including Japan and the trends in technological advancements relating to defense equipment
- (2) Basic matters concerning the roles of the Government of Japan and the Defense Equipment Manufacturers in ensuring stable manufacturing of defense equipment, measures to improve the system for the procurement of defense equipment, and other measures to enhancing defense production and technology bases.
- (3) Basic matters concerning financial and other measures for the Defense Equipment Manufacturers to ensure manufacturing of defense equipment.
- (4) Basic matters concerning measures to smoothly carry out the transfer of defense equipment and technology, which contributes to ensuring stable manufacturing of defense equipment and technology under appropriate control.
- (5) Basic matters concerning the roles that the Designated Equipment Transfer Support Corporation stipulated in Paragraph 1 of Article 15 should play with respect to the equipment transfer support operations stipulated in Paragraph 1 of Article 15 and the fund stipulated in Paragraph 1 of Article 18.
- (6) Basic matters concerning security measures to protect classified information regarding contracts for defense equipment and technology as stipulated in Paragraph 1 of Article 27.
- (7) Basic matters concerning the Government ownership of designated defense equipment manufacturing facilities by the Minister of Defense as stipulated in Article 29 and the entrustment of the management.
- (8) In addition to the matters listed in the preceding items, other matters necessary for enhancing defense production and technology bases.



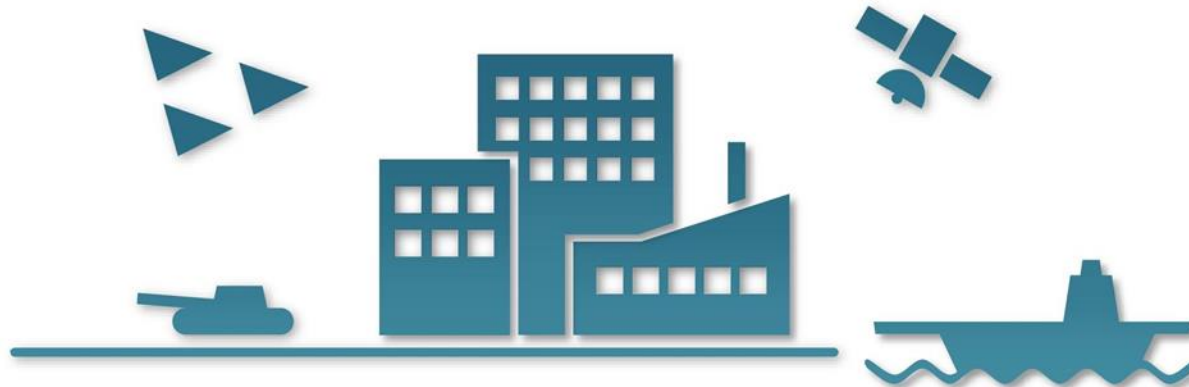
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Chapter 1

Basic Matters Concerning the Security Environment of the International Community, Including Japan, and the Trends in Technological Advancements Relating to Defense Equipment

Section 1 Security Environment of the International Community, including Japan

- ▶ As Russia's aggression against Ukraine attests, the international community, including Japan, is facing serious challenges and has entered into a new era of crisis.*

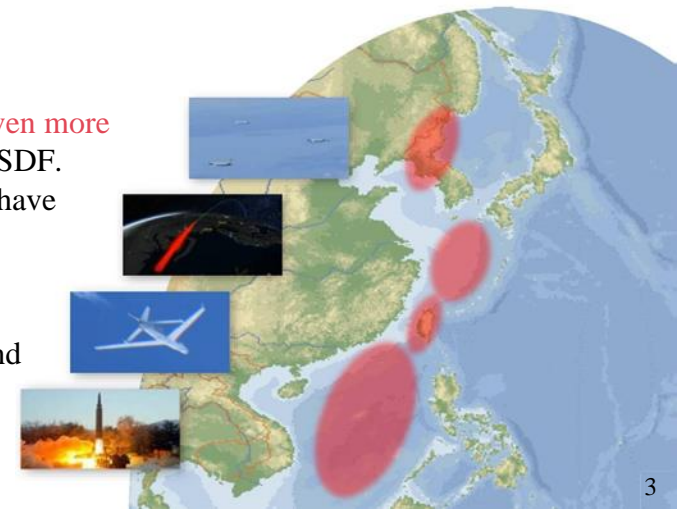
*This perception follows the recognition of the three strategy documents.

Section 2 Trends in Technological Advancements relating to Defense Equipment

- ▶ As science and technology have significantly changed not only society and people's lives but also the paradigm of security, in recent years, various technologies have rapidly been developed, especially in the private sector, and have a significant impact on security.
- ▶ Countries worldwide have advanced the research and development of unprecedented defense equipment and technologies, such as AI, information communication, quantum, additive manufacturing, hypersonic glide vehicles, and high-power energy weapons.

Section 3 Environment Surrounding Bases

- ▶ Amidst calls for fundamentally reinforcing the defense capabilities, **the defense industry has been even more important** in securing defense equipment and technology necessary for carrying out missions of the SDF.
- ▶ Meanwhile, **the defense production and technology bases have been weakening** as more companies have withdrawn from the defense business and fewer new entrants have emerged, due in part to the low profitability, the uncertainty of investment returns, and aversion and reputation risks associated with the defense business.
- ▶ Furthermore, **new risks surrounding the supply chain have become apparent**, such as cyberattacks and export restrictions from foreign governments.



Chapter

2

Basic Concepts of Maintaining and Enhancing Bases

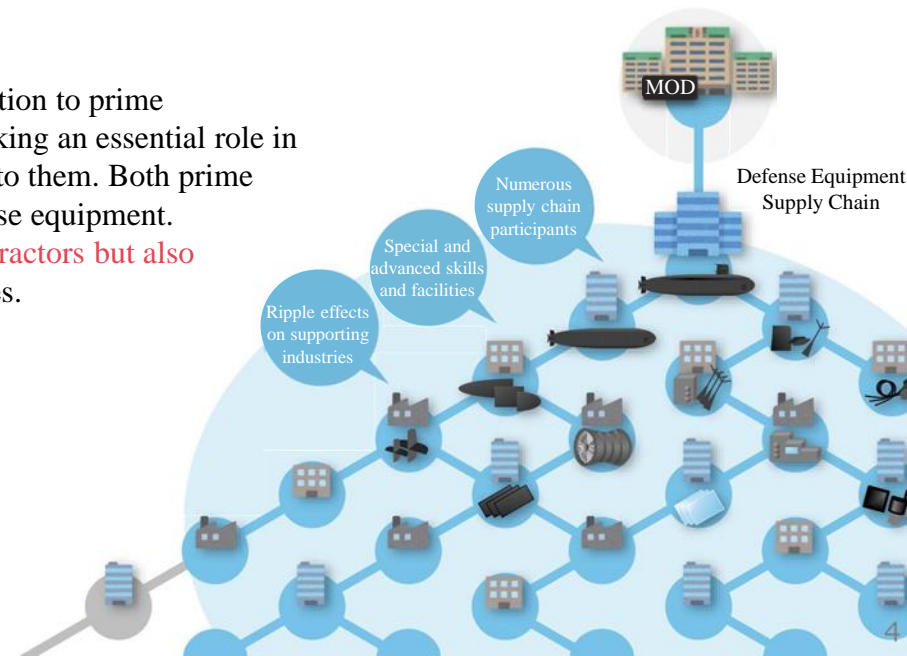
Section 1. Basic Concepts and Directions of Maintaining and Enhancing Bases

1. Significance of Maintaining and Enhancing Bases

- ▶ There has been significance, such as to ensure Japan's independence in security environment, enhance its deterrence, and to contribute economically and technologically to domestic industries.
- ▶ In addition, as countries continue to hoard technologies, **it is increasing the need to maintain and enhance defense production and technology bases in Japan** in terms of ensuring stable manufacturing of defense equipment, which is directly related to national defense, and of maintaining technological superiority.

2. Subjects for which to Maintain and Enhance Bases

- ▶ Defense equipment is an aggregation of many parts and components. In addition to prime contractors that deliver finished products to the MOD, many suppliers are taking an essential role in manufacturing defense equipment, such as delivering parts and components to them. Both prime contractors and suppliers are equally essential to stably manufacturing defense equipment.
- ▶ **The entire supply chain of defense equipment, including not only prime contractors but also suppliers**, shall be in the scope of the measures to maintain and enhance bases.



Chapter 2

Basic Concepts of Maintaining and Enhancing Bases

3. Concepts of Acquisition of Defense Equipment

- ▶ It is a premise, as a matter of course, to acquire defense equipment that meets the standard of required performance, consisting with operational concepts of defense equipment necessary for the defense of Japan. **On top of that, it is necessary to decide on an acquisition method with the viewpoints of a growing need to maintain and enhance bases in Japan.**

When acquiring new defense equipment, **procurement of domestic products is pursued**, focusing on the following areas:

- (1) What can meet various conditions, such as operational concepts, performance, acquisition cost, life cycle cost, schedule, etc., with Japanese technologies
- (2) What is indispensable in light of maintaining war sustainability in the event of a contingency as well as of ensuring the ability to improve operations and maintenance in peacetime (e.g. ammunition, ships)
- (3) What are the items that should not be dependent on foreign countries from the perspective of confidentiality (e.g. communications, encryption technology)
- (4) What is indispensable for realizing operational concepts based on Japan's geographical and policy peculiarities
- (5) What are the latest technologies from foreign countries that are hard to obtain
- (6) What is a potential target of external threats through economic means

* In cases where the procurement of domestic products is difficult, the MOD will **pursue acquisition through international joint development and production or licensed production** from the viewpoints of improving technological capabilities by transferring technology to Japan and securing flexibility for future renovation by Japan.

When it is necessary to select either domestic or foreign products that satisfy the conditions shown in (1), the MOD should decide after evaluating the industrial participation by Japanese companies in each stage of the life cycle of defense equipment to be selected (research, development, production, maintenance, supply, decommissioning, etc.) and **the range and the extent of transferring technologies to Japan.**

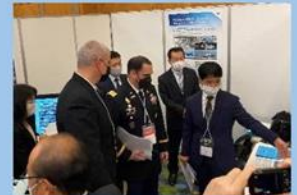
Chapter 2

Basic Concepts of Maintaining and Enhancing Bases

4. Concepts of International Cooperation

- ▶ Given the difficulty to maintain necessary bases without cooperating with other countries, it is necessary to promote international joint research and development in addition to active international cooperation and licensed production, contributing to incorporating the excellent technologies of various countries into Japan's defense equipment.
- ▶ It is impossible to complete supply chains of defense equipment only within Japan so that it is essential for Japan to build a mutually complementary relationship with its ally and like-minded countries.
- ▶ The situation where countries support Ukraine indicates that the necessity of taking measures such as standardizing specifications of defense equipment to guarantee interoperability and interchangeability with other countries is becoming more apparent. It is necessary to develop defense equipment taking into account whether its specification meets the global standards.
- ▶ The transfer of defense equipment and technology is a key policy instrument to ensure peace and stability, especially in the Indo-Pacific region, to deter unilateral changes to the status quo by force, to create a desirable security environment for Japan, and to provide assistance to countries that are subject to aggression in violation of international law, use of force, or threat of force.

The Government will carry forward with the transfer of defense equipment and technology in joint public and private efforts in cooperation with related ministries and agencies by establishing the fund and implementing measures, including providing corporate assistance, to promote the smooth transfer of defense equipment and technology of high-security significance and international joint development in a broad array of fields.



Chapter 2

Basic Concepts of Maintaining and Enhancing Bases

5. The Ideal Future of Defense Industry

- ▶ It is most important to maintain the ability to manufacture the necessary defense equipment and support high operating rates.
- ▶ While defense-related companies in foreign countries, such as Western countries, are normally engaged in defense projects for their main businesses, major defense-related companies in Japan are fundamentally engaged in commercial businesses for their primary businesses. In almost all cases, their defense-related sales account for lower than 10% to total sales (defense demand dependence).

Low defense demand dependence leads to such a tendency as lower priority of resource distribution within the companies. In order to make the defense industry internationally competitive, it is important to build a defense industry led by companies for which defense business is their main priority. However, it is important to keep in mind that the nature of an organization depends on what such a company determines for its management. It is necessary to continuously exchange opinions fully between the public and private sectors on effective policies for making the defense industry competitive.

Section 2. Roles of the Government of Japan and the Defense Equipment Manufacturers in Ensuring Stable Manufacturing of Defense Equipment

- ▶ It is crucial for the Government to go on with maintaining and enhancing bases by placing importance on preparing an environment for the Defense Equipment Manufacturers to be engaged in defense projects and determine to further continue. The Defense Equipment Manufacturers are also expected to make efforts on their initiatives to maintain and enhance bases, newly recognizing that they are essential entities responsible for national defense.
- ▶ Due to the relation that the MOD/SDF is the defense capability while defense production and technology bases are a virtually integral part of defense capability itself, the MOD/SDF and the Defense Equipment Manufacturers must play each role with shared recognition on matters such as defense buildup and operational concept.

Discussion sessions with 15 prime contractors



Chapter **3**

Basic Matters Concerning Measures Based on this Act

Section 1 Ensure Stable Manufacturing of Defense Equipment*

*Excluding civilian products.
The same applies hereinafter.

- ▶ The Minister of Defense confirms whether or not the Stable Manufacturing Plans related to specific initiatives (such as supply network resiliency, efficient manufacturing processes, cybersecurity enhancement, and business succession) are **indispensable for stable manufacturing of designated defense equipment to be delivered to the MOD**, and then approves the Stable Manufacturing Plans.
- ▶ After concluding contracts on the specific initiatives with Defense Equipment Manufacturers, whose Stable Manufacturing Plans are approved by the Minister of Defense, the MOD directly pays necessary costs without delay to them in accordance with the provisions of said contracts.

Section 2 Smoothly Carry out the Transfer of Defense Equipment and Technology

- ▶ A grant will be awarded **to the prime contractors and suppliers which take partial roles, such as designing for design modifications and the subsequent work.**
- ▶ Since the adjustment of specifications and performances is **requested from the Minister of Defense to the Defense Equipment Manufacturers to ensure confidentiality of information regarding defense equipment as well as from the necessity of national security, the Government should cover the cost.** Additionally, even if equipment transfer expected in an international competitive bid, etc., was not realized, the Defense Equipment Manufacturers will not be requested to return the costs of the adjustment of specifications and performance they had already spent.

Section 3 Designated Equipment Transfer Support Corporation

- ▶ The Designated Equipment Transfer Support Corporation will provide supporting service to ensure that **equipment transfers align with the MOD's political objectives.**

Chapter 3

Basic Matters Concerning Measures Based on this Act

Section 4 Security Measures to Protect Classified Information Regarding Contracts for Defense Equipment and Technology

- ▶ When it is necessary to share documents containing classified information such as Ministerial Confidential with contractors, the MOD designates such information as “Defense Equipment Confidential” and provides the information to the contractors along with “Defense Equipment Confidential Designation Document,” which describes instructions, including its marking and effective period. This allows contractors and their employees to manage information more rigorously.
- ▶ While ensuring effective prevention of leaks of Defense Equipment Confidential, the MOD will fully explain to contractors the necessity of safeguarding Defense Equipment Confidential to gain their understanding and continue the steady implementation of existing security measures.

Section 5 The Government Ownership of Designated Defense Equipment Manufacturing facilities by the Minister of Defense, and the Entrustment of the Management

- ▶ When it is difficult to ensure stable manufacturing of designated defense equipment even if the measures of Chapter 2 of this Act are applied, the MOD acquires designated equipment manufacturing facilities, etc. which manufacture the designated defense equipment. This measure is expected to reduce risks that the Defense Equipment Manufacturers are supposed to incur when owning fixed property and to ensure the sustainability of production for defense equipment by.

For example, this measure may be applied in the following cases.

- ▷ When a contractor withdraws from business such as manufacturing defense equipment and:
 - There is a Defense Equipment Manufacturers capable of manufacturing defense equipment if it doesn't need to take on any risk of owning designated defense equipment production facilities by itself.
 - Even though there is a business successor in the defense industry, the designated equipment manufacturing facilities related to the withdrawal have exceeded their useful life of the building. The successor finds it challenging to acquire new facilities, so the Government builds new ones instead.
- ▷ When designated equipment manufacturing facilities are destroyed due to accidents or natural disasters, and the process and duration of recovering the facilities by the Defense Equipment Manufacturers are uncertain, the Government would build new ones.

With these assumptions, specific cases must be examined individually, considering the necessities in various situation

- ▶ Such acquisition fundamentally relies on the presence of Defense Equipment Manufacturers, who engage in manufacturing designated defense equipment on consignment from the MOD.
- ▶ As stipulated in paragraph (1), Article 33 of this Act, it is encouraged for the Government to promptly cede the land acquired for designated defense equipment manufacturing facilities. On the other hand, given that this Act's primary objective is to ensure the consistent manufacturing of defense equipment, it does not mandate the Minister of Defense to cede the land going so far as to causing troubles to hinder this objective.

Chapter **4**

Other Matters Necessary for Maintaining and Enhancing Defense Production and Technology Bases

(1) Making the Defense Business more Attractive (Proper Profit Calculation)

Create an attractive business environment in which the private enterprises pursuing profit will want to engage.

(2) Maintenance and Reinforcement of Competitiveness and Technology of Companies

Promote appropriate competition and innovation, ensuring Japan's technological superiority in the security domain.

(3) Revitalization of the Defense Industry (Promotion of New Entries)

Foster new entries into the defense industry, stimulating overall industry activity and incorporating cutting-edge technologies from the private sector into the security domain.

(4) Appropriate Responses to Withdrawing Companies

Minimize the impact of business withdrawal on the supply chain and ensure stable manufacturing of defense equipment.

(5) Building a Resilient Supply Chain

Reduce risks in the supply chain through proactive cooperation by Defense Equipment Manufacturers and mutual complementation with other countries.

(6) Strengthening Industrial Security

Ensure international security standards, respond to cyber threats, and ensure progress in technological cooperation with other countries.

(7) Strengthening Sensitive Technology Management

Strengthen the management of sensitive technologies at the Government level, fostering collaboration with other countries.

(8) Promotion of Transfer of Defense Equipment and Technology

While providing support to companies as needed, the Government will take the lead and promote further cooperation between the public and private sectors.

(9) FMS Rationalization

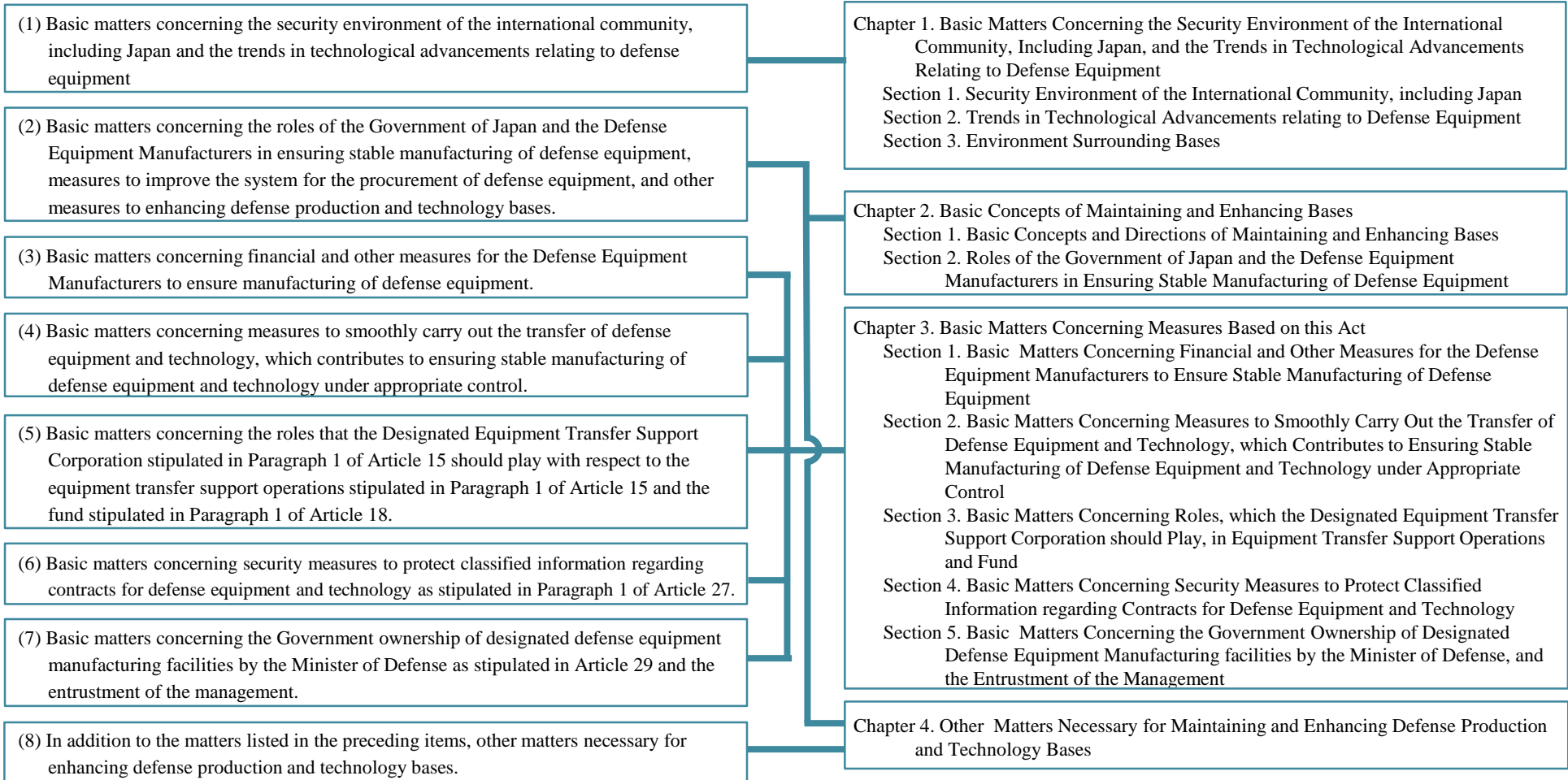
Even as the amount procured through FMS remains at a high level, the Government ensures to maintain and enhance defense production and technology bases in Japan.



Correspondence between Laws and Basic Policy

Act on Enhancing Defense Production and Technology Bases (Act No. 54 of 2023)
Paragraph 2 of Article 3

This Basic Policy (draft)





(3-③ Reference) Cybersecurity Enhancement: Measures for Enhancing Bases (Conceptual)

1 Clarify the position of the defense industry

- Clarify that **maintaining and enhancing defense equipment production and technology bases is becoming increasingly important.**
- The Minister of Defense formulates and announces Basic Policy concerning enhancing bases.

2 Investigate the supply chain

- The Government conducts investigations **to directly identify the risks in the supply chain.**
- Businesses** are not compelled to respond to the investigation but **are obligated only to make a sincere effort.**



(4 Reference) Equipment transfer Air defense radar that may be subject to transfer

→ The results of the investigation will be utilized for measures to enhance bases.

3 Measures to enhance the bases

- Upon certifying the initiatives of businesses that contribute to enhancing the bases, **expenses will be paid directly** (also to supplier companies).
- This action addresses supply chain risks and promotes the enhancement of the bases.



- Supply Chain Risk Handling
- Manufacturing Process Efficiency
- Cybersecurity Enhancement
- Business Succession, etc.

6 Government ownership of manufacturing facilities, etc.

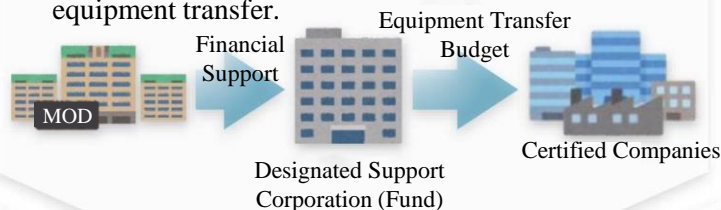
- When there are no other means even after taking other measures, the Government acquires manufacturing facilities and outsources their management to businesses.
- These actions ensure the manufacturing and appropriate procurement of defense equipment.



(3-② Reference) Streamlining of manufacturing process, Top: Conventional manual manufacturing process, Bottom: Automation by introduction of metal 3D printer (image)

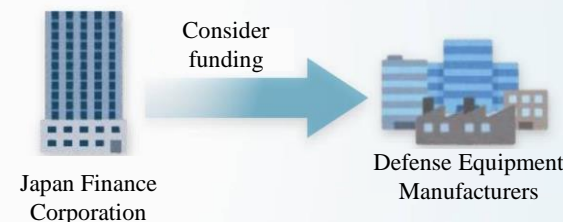
4 Smooth transfer of defense equipment and technology

- Manufacturers will be **funded for the necessary expenditure when the specifications and performance of equipment to be transferred are modified** at the request of the Government for the purpose of equipment transfer.



5 Lending funds

- Japan Finance Corporation will **consider lending funds** necessary for the manufacturing, etc. of defense equipment.



7 Protect classified information concerning contracts for defense equipment and technology

- For the enhancement of the security of sensitive information related to defense equipment and technology, the obligation of confidentiality is shifted from contractual to legal.



(6 Reference) Examples of government-owned manufacturing facilities, etc., in the United States: Top: Air Force United States Air Force Plant 4 Bottom: Army Joint Systems Manufacturing Center