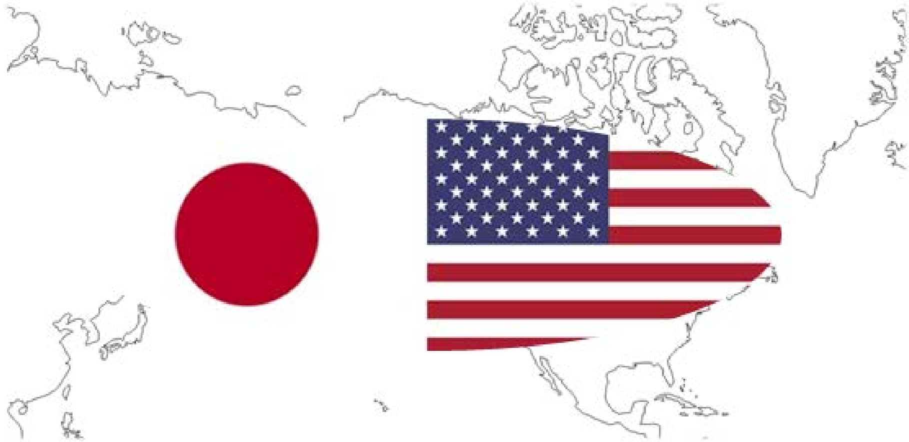

The Framework for a U.S.-Japan Free Trade Agreement

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The Project 2049 Institute seeks to guide decision makers toward a more secure Asia by the century's mid-point. Located in Arlington, Virginia, the organization fills a gap in the public policy realm through forward-looking, region-specific research on alternative security and policy solutions. Its interdisciplinary approach draws on rigorous analysis of socioeconomic, governance, military, environmental, technological and political trends, and input from key players in the region, with an eye toward educating the public and informing policy debate.

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The Framework for a U.S-Japan FTA

The United States and Japan can create a bilateral free trade and investment agreement that both sides will sign and ratify.

Such an agreement will not require Japan to make agriculture market concessions beyond the Trans-Pacific Partnership or the recent draft agreement with Europe.[1] Yet, it will offer the U.S. not only diplomatic improvement but also worthwhile *economical* benefits. A U.S.-Japan FTA will appeal to governments that wish to enhance competition and property rights and could eventually pressure governments that act to undermine competition and property rights. More specifically, it will appeal to American allies and friends who want a zone of open market in Asia as an alternative to Chinese state capitalism. The economic terms are set out below.

The agreement will also have considerable geopolitical benefits. First, it would strengthen the alliance at a time when both sides are searching for the means to counter pressure from China. Second, it could give the "VIP" – Vietnam, Indonesia, and Philippines – countries a path to become a richer, stronger, more market-oriented, and perhaps a more democratic country. Third, it could enhance the role of the United States in the energy sector, to consolidate its "sole superpower status." Fourth, it could invigorate the U.S.-Japan defense alliance relationship by raising IP standards for a more secured industrial cooperation.

Past Time For A Strategy Change

The "free world" has long depended on the U.S. to lead efforts to reduce global tariffs, and critically, to give political elites in developing countries external reasons to conduct internal, pro-market reform. In Asia, the core of early post-war American strategy was the decision to encourage the rebuilding of Japan in the context of a bilateral alliance. As the Cold War in Asia intensified, the U.S. then undertook a similar approach with South Korea and Taiwan. The geostrategic motivation was to shape a set of allies who were rapidly growing after adopting the aspects of the free market. The U.S. would benefit from stronger allies and an economic agenda consonant with its own ideological preferences.

This worked in part because the U.S. was willing to accept trade deficits, which encouraged the U.S. trade partnership countries with the benefits of accepting American trade policies. The key to American economic strategy in Asia during the Cold War was not truly free trade, therefore, it was tolerance of asymmetric trade. This allowed Asian countries to produce more than their domestic markets could absorb and store the foreign currency earned in American's debt.

The strategy worked well, resulting in strong and more prosperous allies. By the late stage of the Cold War, American allies had experienced very fast growth and many countries had transitioned into democracies. Indeed, the U.S. strategy was so attractive that a once-Maoist China chose the same economic (only) course its Asian neighbors had. By the 21st century, global growth was found first and foremost in the United States and China. But China still remains a foe both geopolitically and in terms of authentic trade liberalization. Today, Americans, Japanese, and others are asking whether the economic "bet" – encouraging Chinese entry into the WTO – was worth it, as China has become a rival instead of a partner.

The U.S. and Japan now watch warily as China turns its greater wealth into military power and diplomatic prestige. Both countries are concerned about China's non-market behavior, including coercion on trade and investment terms, theft of intellectual property, and "standard setting" in technology such that third parties, such as ASEAN, may be trapped into long-run dependence on Chinese technology. In addition, American and Japanese leaders grapple with what the much-heralded "One Belt, One Road" initiative will mean for geopolitics. While Beijing faces financial limitations to its ambitions to connect Europe and Asia by sea and land, China does have enough money to invest in projects that support elites who might then do its bidding on key issues.

Tokyo and Washington rightly worry that, should they fail to upgrade Asia's economic arrangements, China's state capitalist model will prevail, bringing with it political influence in key countries. A recent example of successful Chinese geopolitical pressure was the ASEAN Foreign Ministers meeting in August, when all members except Vietnam yielded to China and set aside a binding Code of Conduct in South China Sea.

Two salient implications from the post-war Asia experience therefore follow: (i) while the driver of the "East Asian Miracle" was not genuine free trade, domestic American discontent means that may now have to change and (ii) the failure to induce China to liberalize means ensuing free trade agreements should focus sharply on friends and allies.

Just as with its ideological and military competition with the Soviet Union, the U.S. needs strong and growing partners as its competition with China intensifies. And just as before, Japan remains the most important of these partners both economically and in terms of its potential defense contribution. Absent the free trade agreements, the smaller countries in Southeast Asia may be tempted by Chinese economic inducements. All these points argue for arrangements that promote truly open trade and have some degree of attraction to most American allies and friends.

An obvious issue to raise here is the struggles of the Trans-Pacific Partnership (TPP). The TPP initially appeared to qualify as the new approach the U.S., Japan, and East Asia needed. It failed because it did not sufficiently promote free markets[2] and therefore could not generate enough support to overcome traditional protectionist opponents, such as labor unions, in the United States.

Nonetheless, the TPP did clarify the value of a directly related initiative: a U.S.-Japan bilateral agreement. Because the U.S. and Japan have more common economic interests than the TPP's group of 12, a bilateral agreement can be more effective than the TPP at opening services trade, protecting intellectual property, and limiting state-owned enterprises, which would be vital in winning American political support. Related, a bilateral agreement involves no fear of job loss due to low wages. Another potential improvement that has been overlooked until now is that a bilateral agreement can encourage American energy production in a manner benefitting both the U.S. and Japan.

A Bilateral FTA

The following outlines what such an agreement should look like in order to work both economically and in terms of domestic politics, on trade and investment issues from agriculture to trans-shipment.

Agriculture

This is the most difficult area for Japan, but the U.S. can, and should, adjust to Japanese domestic politics. The TPP terms were accepted by most American farm groups and can serve as a baseline for negotiations.[3]

The U.S. should commit to the TPP level of access in agriculture, with no demands for additional access without a simultaneous rollback of one of Japan's previous TPP concessions. While rollbacks are politically charged, the TPP included major agriculture producers competing with American farmers. A bilateral agreement offers less benefit, but also less of this drawback. This may make it desirable to alter terms while keeping the level of Japanese market opening unchanged. Japan's major agriculture commitments in the TPP were as follows:[4]

> **Beef:** Reducing the tariff on fresh, chilled, and frozen beef cuts from 39 percent to 9 percent in 16 years. Tariffs on processed beef products including beef jerky and meat extracts, currently as high as 50 percent, eliminated in six to 16 years.
>
> **Pork:** Elimination of more than 65 percent of pork and pork product tariff lines within 11 years and nearly 80 percent within 16 years. The 20-percent tariff on ground-seasoned pork and 10-percent tariff on sausages eliminated in six years.
>
> **Poultry and Eggs:** Tariffs on poultry, eggs, and egg products eliminated in six to 13 years and tariffs on fresh and frozen cuts, as high as 12 percent, in six to 11 years. For egg yolks, the top category for the U.S., tariffs as high as 24 percent eliminated within six years.

Dairy: Many cheese tariffs, ranging up to 40 percent, eliminated in 16 years. This includes cream cheese, pizza cheese, grated cheese, and cheddar. Two tariff-rate quotas of 3,188 tons each, growing to 3,719 tons over five years, created for butter and milk powder.

Wheat: A 114,000-ton, country-specific quota (CSQ) that grows to 150,000 tons in seven years. Beyond that, the 17 yen per kilogram mark-up cut by 45 percent over nine years. For processed products, existing tariffs, as high as 26 percent, eliminated in six years.

Corn: Immediate elimination of the 3-percent tariff applied to in-quota corn other than feed. A new CSQ for corn and potato starch at 2,500 tons, growing to 3,250 tons by year six.

Rice: A new, duty-free CSQ for rice, starting at 50,000 tons and growing to 70,000 in 13 years. Immediate elimination of the tariff on "other animal feeds, containing rice."

Soybeans: Tariffs on soybean products, as high as 21-percent, eliminated in six years. Immediate elimination of the 4-percent tariff on soybean meal.

Japan has special sensitivity in beef, dairy, wheat, and rice. Meanwhile, corn, soybeans, pork, and chicken are among the largest American farm products by sales.[5] As an illustration of a possible change, the U.S. could ask for a larger CSQ in corn in exchange for abandoning the rice CSQ. For a bilateral agreement to work politically for Japan, the U.S. must agree to limit itself to this kind of proposal. The payoff to doing so is seen below.

Digital trade

A key reason to upgrade old or sign new trade agreements is to incorporate specific rules for digital trade – international trade conducted through the internet, such as movie downloads.[6] This should be both easy and beneficial in a U.S.-Japan bilateral, since a new and complete American position on digital trade will have been proposed in the talks updating the North American Free Trade Agreement (NAFTA).

The basic goals for digital trade in a bilateral agreement are simple:

1) The guiding principle should be the free flow of data.

2) Similarly, customs duties on cross-border electronic transactions should be banned.

3) While conventional quotas may not apply, policies which support quantitative restrictions on digital trade volumes should be banned, including subsidies and restrictions of internet access.

4) The WTO principle of non-discrimination against foreign goods should be extended to digital trade. Among other things, this implies data localization should be sharply restricted.

5) Coercion of intellectual property (IP), such as forced disclosure of source code, as a condition of permitting digital trade should be banned.

Some lower-income economies are concerned about being overwhelmed by electronic goods from more sophisticated platforms in higher-income economies. The U.S. and Japan have no such clash, permitting quick agreement on a near-ideal digital trade chapter. The terms of the bilateral agreement regarding data flow and digital trade can and should be stronger than those of the TPP. This will benefit both economies and serve as a high standard to be used in other agreements. Gains are not only economic: the free flow of data clashes directly with data barriers, control, and manipulation advocated by many authoritarian governments.

Energy

The TPP largely skipped over energy trade and investment, partly because duties on energy products were already low and partly because the Obama administration did not want to be seen encouraging U.S. investment in, and production of, fossil fuels. American energy exports, however, are potentially valuable for both the U.S. and Japan. The goal should be large American gas exports to all customers and targeted oil exports that can change market conditions in specific circumstances. This would both maximize American exports and create a more favorable global energy setting for Japan.

A bilateral agreement cannot reach this goal, but it can bring the outcome closer. The U.S. has liberalized energy exports but fossil fuels remain highly politicized, and a partial reversal could be prompted by environmentalists in the next administration.[7] A U.S.-Japan bilateral agreement can protect Japan's status as a recipient of American gas, oil, and coal and make it more difficult both politically and economically to curb American energy exports.

Aside from trade, investment can also boost U.S. production and Japanese consumption. A bilateral agreement should give the two countries' energy investors national treatment. While a core WTO principle, national treatment has not been typically applied in energy. It should be utilized to erode existing barriers. For example, this could include Japanese investment in terminals for liquefied gas shipments in the U.S. and American participation in energy subsectors where Japan made TPP reservations.[8]

Investment

Several investment issues may become troublesome. In the past, the U.S. has claimed it does not receive national treatment for investment in Japan, despite the 1953 Treaty of Friendship. This may be reflected in the fact that Japan's non-conforming measures (NCM) for investment in the TPP are considerably more extensive than the United States'.[9]

A bilateral agreement makes improvement possible. Japan cited national security for multiple restrictions, for example, in telecommunications and pharmaceuticals. When negotiating only with an ally, such concerns are lessened, and part of the motivation for a U.S.-Japan bilateral agreement is strengthening the alliance. The same rationale also applies to aerospace and armaments, sectors that are understandably sensitive but less so in the U.S.-Japan context. It should be possible to strike some of these NCM.

Both countries made repeated TPP investment exceptions in transportation, especially air and shipping. These may stem ultimately from America's antiquated Merchant Marine Act of 1920 (also known as the Jones Act).[10] If the Trump administration maintains support for the Jones Act, it will not be possible to liberalize investment in transportation services, but it is worth discussing again in a bilateral context.

The most controversial topic in this area is investor-state dispute settlement (ISDS). The Japan-European Union negotiations split on ISDS, with Japan wanting to retain some version of the system. This would seem to align Japan with the U.S., which has consistently supported ISDS. However, ISDS is a lightning rod within the U.S., and its inclusion could prevent Senate passage of a bilateral agreement. [11]

While opposition to ISDS solely involving Japan and the U.S. is not well founded, its critics can understandably object to the precedent. American and Japanese negotiators should be able to agree on ISDS terms, but may decide not to include them. A compromise is to flesh out a rigorous process, but make participation voluntary. The two governments would agree to participate because they support ISDS, not because of a treaty requirement.

Intellectual property

Intellectual property is a critical issue where Japan and the U.S. are closer to each other than any lager group could be and closer than almost any pair of countries. There are debates over what constitutes excessive IP protection. Proponents of less protection are misguided with respect to international negotiations, because global standards remain far below the point where IP protection may discourage innovation. Japan and the U.S. can set a "high floor" for IP protection that encourages innovation while avoiding substantial domestic change.[12]

A U.S.-Japan bilateral agreement should include both IP provisions that can be extended globally, and others which are not easily extended, but which benefit the two parties. The primary issue is enforcement. Countries with weak rule of law do not enforce agreed upon IP protection, for example, with regard to trade secrets.[13] The failure is compounded if goods and services utilizing stolen IP are then exported due to lack of border measures. Poor countries may impose penalties that genuinely fit their legal systems, but are too small to deter IP violations.

For a U.S.-Japan bilateral, rule of law is established, and courts can hand out stiff penalties. Border measures could be improved, but this is not due to lack of regulation. A treaty offers only greater certainty in these areas. Elsewhere, though, outright advances are possible. While the term of patent protection is controversial, quick and secure (with regard to data) patent approval is more important in many cases. Japan and the U.S. can set high standards for patent evaluation. Also, being developed economies, Japan and the U.S. rarely have need to infringe IP for public health, permitting high IP protection standards for biologics and other goods.

These and many other individually small improvements in IP protection can be a vital achievement for the U.S. because innovation is the most important American comparative advantage. IP-intensive goods exports exceeded $840 billion in 2014, about half the U.S. total. Industries that rely on IP employed 28 million Americans in 2014 and helped support 17 million other jobs. The industries added $6.6 trillion in value. Innovation also plays a role in industries that are not IP-intensive.[14]

Labor and Environment

Proponents of strong labor and environment provisions in trade deals are right to point out that the provisions do not seem to have much impact. Their response is to insist on stronger terms, which provokes opposition from groups with other negotiating priorities.[15] Another advantage of a U.S.-Japan bilateral agreement is that labor and environmental issues are almost moot because there is little difference between the two parties.

An honest assessment reveals that the basis for labor and environment objections to open trade is the idea that poorer countries will pay workers (much) less and damage their environment more, becoming attractive to multinationals as bases for production and exports back to their home markets. This does not apply to Japan and the United States, neutralizing a large political headache. The two parties can craft a simple labor and environment chapter that serves as a guideline to trade agreements involving only richer economies.

Services

It is vital for U.S. Senate passage of a bilateral agreement that American exports are likely to expand. While a great deal of attention is paid to agriculture, U.S. service exports exceeded $750 billion in 2016, more than five times the size of farm exports.[16] The single most important factor in the death of the TPP was the weak outlook for services exports, which was due in turn to the overwhelming number of NCM's demanded by the 12 parties and the uncertainty these created.[17]

The principles governing services trade should be the same as goods trade, in particular, national treatment. Most governments flinch at national treatment in "sensitive" services, but this was also true in the past for goods. What is actually sensitive has been whittled down.[18] A bilateral agreement should treat American and Japanese service providers as domestic. In particular, as in investment, transport trade has proved strangely difficult for the two parties. It is not only unjustified on a bilateral basis to treat American and Japanese services providers as somehow untrustworthy; it sets a foolish precedent globally for two countries competitive in services.

Elsewhere, a chunk of the TPP failure on services in the form of NCMs is eliminated simply by not negotiating with so many countries. However, the U.S. and Japan should go beyond merely eliminating the NCMs demanded by Vietnam and others. For the U.S.-Japan bilateral agreement in particular, the technology restrictions the U.S. imposed in the TPP should be eased. If it is not possible to mitigate the financial services exemptions for individual American states, the U.S. needs to offer other concessions to open its partners' financial services market further.

Japan's NCMs were considerably more extensive. If a bilateral agreement is to work, Japan will have to provide greater services market access to the U.S. than it was willing to offer the larger group. Three obvious areas to do so in terms of economic benefit to both sides are the energy and power supply sub-sectors, freight forwarding, and firms that match jobs and workers.

State-Owned Enterprises

The pivotal issue in addressing state-owned enterprises (SOEs) is whether Japan and the U.S. are purely thinking bilaterally or also about multilateral precedent. A chapter solely concerning bilateral SOE matters would be short, easy, and unimportant.

Trying to create the right global rules on SOEs is challenging technically, and possibly politically. It also has a very high payoff. Particular governments committed to SOEs, such as Singapore, are more interested in protecting them than improving trade and investment. The general problem has been a willingness to believe that SOEs can be made into genuinely commercial entities. This is incorrect. Most important, SOEs do not go bankrupt, which immediately undermines competition. They exist not to compete or to otherwise resemble private firms, but precisely because governments do not want private firms acting in certain roles.[19]

It would be extremely difficult to force governments who value SOEs to truly commercialize them. TPP provisions, for example, did not apply to plurality (non-majority) state-owned firms, sovereign wealth funds, or most subnational entities. A country like China could evade this kind of SOE requirement with no difficulty. A far better approach is to ban SOEs from nearly all sectors, using a broad definition of what qualifies as an SOE.[20] Adjustment periods to wind down SOEs should be included in a U.S.-Japan bilateral, even if not directly relevant.

It is worth noting that the U.S. and Japan included in the TPP their own carve-outs for a few finance-related SOEs as well as extensive protection for subnational entities. This naturally permits other countries to defend their own SOE exceptions. A global agreement along these lines would be useless at the subnational level and accumulate SOE exceptions at the national level in every major sector. The payoff to very tight limits on the number of SOEs in a U.S.-Japan bilateral is potentially enormous.

Trans-shipment/Expansion

Rules of origin — the guide for what goods and services receive the benefits of liberalization in a trade agreement – normally pose a difficult choice.[21] Tight rules risk creating a bloc, not expanding trade, while loose rules allow non-parties to gain from the agreement without market access concessions. The somewhat protectionist political mood in the U.S. adds another dimension: support for a bilateral agreement with Japan would drop if it were seen as a means for low-wage countries to ship goods through Japan to the United States.

Loose rules of origin might still work in a bilateral agreement because the U.S. trusts Japanese trade governance. Even so, they would make expanding the agreement to other countries much more difficult. Other countries would try to trans-ship, rather than meet a high-standard trade deal, and the U.S. is more likely to reject expanding the agreement if rules of origin are loose.

The superior path in this case is for the U.S.-Japan bilateral agreement to have tight rules of origin. This would admittedly increase the risk of diverting trade instead of adding to it. It would therefore have to be balanced by a stated commitment from both parties to seek to expand the agreement to any country willing to meet the terms. Such a commitment, which would have to be ratified by the Congress and the Diet, making it more likely they would approve future agreements. This is the correct balance for restricting benefits to those undertaking liberalization while avoiding a trade bloc.

Whatever the choice on open or closed rules of origin, they should be as brief and simple as possible. Both Japan and the U.S. have trade treaty commitments to other countries, which already can be complex.[22] A bilateral agreement with extensive rules of origin risks undermining the whole enterprise, participating companies and individuals may not understand which rules apply and when, so their behavior either does not change or even changes in such a way that trade or investment is reduced.

The Economic Upside

What the Trump administration, along with organized labor and a few other groups, wants most from trade agreements is a guaranteed reduction in the U.S. trade deficit. It is, of course, impossible to guarantee such an outcome. It is possible to allow Japan and the U.S. to suspend certain provisions of a trade agreement in the case of a sharp change in the bilateral trade balance, but it would be difficult to negotiate. How big a change qualifies, what provisions can be suspended, and for how long? Further, notwithstanding the political attention to the trade deficit, there is no evidence that a larger trade deficit costs Americans jobs (this is merely assumed).[23]

In contrast, the agreement outlined here would ensure:

1) Japanese agriculture markets are open to the same extent as specified in the TPP, benefitting both American producers and Japanese consumers.
2) Digital trade would see non-discrimination and zero duties (which should already have been done in the NAFTA revision).
3) Better integration of the American and Japanese energy markets in trade and investment, thereby encouraging greater American energy exports globally.
4) ISDS would be less of a political obstacle to an agreement, even while the American and Japanese government can voluntarily accept the process.
5) Pressure for a higher global standard for IP protection.
6) Critically, greater American services exports, bilaterally and possibly globally, through limiting exemptions from trade competition in the service sector.
7) A sharply limited number of SOEs.
8) The combination of exclusionary rules of origin with an explicit goal of expanding the agreement to other parties willing to fulfill the requirements.

These embody gains in agriculture, e-commerce, energy, services and in any sector where IP has been infringed or SOEs have limited competition, not to mention the security side.

Geopolitical Benefits

A U.S.-Japan FTA must work economically but it can be a " two for one" with both economic and geopolitical benefits. From the latter perspective, the most important provisions of a bilateral agreement concern energy, IP, and SOEs.

Energy

Perhaps the biggest set of gains from a bilateral agreement are in energy. The shale revolution and the pivotal role the U.S. now plays in the global energy market is a critical change that has not been exploited geopolitically. If pro-market energy trade and investment terms were enacted, the U.S. and Japan would see enhanced energy cooperation on multiple dimensions. The vagaries of American politics would be much less of a threat to exports, and there would be cross investment in the American and Japanese energy and power sectors. Japan aspires to re-sell liquefied natural gas (LNG) and become a regional trading hub. Other agreements would need to be worked out between the two countries' energy stakeholders, but an FTA is the *sin quo non* of these ambitions.

More energy on the market would lessen Japan's dependence on the Middle East, a substantial benefit. In turn, the U.S. would solidify its status as a major producer and exporter of energy – a critical requirement for the U.S. remaining a superpower.

Intellectual Property

The merits of strong IP protection extend to closer U.S.-Japan defense and security cooperation. The IP terms set out above can strengthen related defense information assurance agreements. Given U.S. parsimony in data and technology protection, the American defense industry is still prohibited from engaging Japanese industry in cooperation on sensitive topics, despite the passage of a series of cyber and "secrets" laws by Japan. A strengthened IP regime that addresses the digital economy would provide an important framework for Japan to improve upon its defense technology protection laws, paving the way for greater cooperation in the most sensitive areas of security, such as cyber security.

An FTA with the highest IP standards would also set the stage for more innovative models of defense cooperation, sorely needed in a geopolitical competition with a China that is becoming a large weapons supplier. Given rapid changes in a competitive Asian defense market, the U.S. and Japan should move toward joint exports to third parties, particularly India and the VIP countries.

For example, Japan could learn much about international arms sales after its disappointment in the outcome of the Australian submarine tender. The loss of the submarine competition to France has set back Prime Minister Abe's ambitions of turning Japan into an arms exporter.[24] In turn, the U.S. has faced difficulties in breaking into the Indian defense market, whereas Modi and Abe have a close relationship.

Vietnam is another potential destination for U.S.-Japan defense exports. Vietnam needs to reform its defense sector in order to quickly build up the capacity to resist Chinese coercion. It will have to put itself in a position to import equipment from the "free world," and if it wants closer ties with the U.S. and Japan it will have to gradually end its dependence on Russian weapons. Japan is not viewed with the same historic baggage that the United States carries. Joint defense exports to Vietnam could be more politically palatable to Hanoi then depending too much on American sources of equipment.

Defense trade is a key tool of American statecraft, one the U.S. is letting atrophy in a global competition. A new model of cooperative joint exports would nod to new realities and leverage changed political dynamics in Japan. Japan and India are growing closer, thanks in large measure to the common worldviews of Abe and Modi. The U.S. and Japan could work on their first-ever joint submarine/anti-submarine warfare package to India, which would be a substantial move to strengthen the trilateral cooperative agenda. The IP provisions in the FTA, plus an opening by Japanese defense companies to U.S. investment and cooperation, could tighten the alliance and shape regional security in ways unimaginable just a few years ago.

SOEs

The geopolitical Achilles heel of the TPP was the weak restraint on SOEs – it would have been an agreement that China could join without substantially reforming its economy. It would have also impaired the goal of strengthening Vietnam and, eventually, the other VIP countries. The U.S. and Japan want to see these countries grow stronger through the far more powerful and sustainable engine of private sector, not state-led growth.

Furthermore, the U.S. has a strategic interest in seeing China shed itself of its SOE system. The return of the state-sector is one of the largest points of contention between the U.S. and China, and the main harm (along with China's history of IP theft) to American workers and companies of Beijing's economic actions. In addition, China's state-led growth could be a tempting model for other elites in the region, who want short-term political gains. Any agreement that allows SOEs substantially to remain in place would hurt regional growth and undermine the U.S. interest in creating a free-market zone in Asia.

This weakness gives the U.S. and Japan an opening to offer countries an alternative and an aspiration: to join a U.S.-Japan free trade area that gives a country's leaders an external reason to dismantle their SOEs and enact free market reforms. Vietnamese SOEs in particular are notoriously wasteful and restrictions on their role would enable massive growth in a market context. Conversely, if Vietnam were to dismantle its SOE structure it could take off the way South Korea did in the 1970s and 1980s. Vietnam and others would also have the opportunity to become a better IP actor than China, making them a preferred partner for many multinationals and countries.

Summary

The U.S. and Japan have a chance to implement an Asian geoeconomic strategy with broad geopolitical implications. The U.S. can solidify its position as an energy exporter; the two countries can set the standard for "innovation" economies with positive spin-offs for defense industrial cooperation, and the two sides can catalyze the dismantlement of SOEs to give Vietnam and others something to which they can aspire. A bilateral agreement must be an economic good. It will also be more popular in the U.S. if sold as a pushback against China. If the two countries further consider a bilateral agreement a stepping-stone toward a pro-freedom political and economic structure in Asia, as well as strengthening security ties, an FTA will garner a broad base of support

End Notes

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