Japan’s Global and Domestic Futures:
The U.S. Relationship and FinTech

CJEB’s annual Tokyo conference
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Welcoming Remarks

The Center on Japanese Economy and Business (CJEB) held its annual conference in Tokyo on May 25, 2017. This year it was titled “Japan’s Global and Domestic Futures: The U.S. Relationship and FinTech.” The conference is a forum to encourage the examination of significant Japanese domestic and international developments. CJEB has enjoyed playing a unique and vital role in bringing together business, government, and academic leaders for an active discussion.

Hugh Patrick, director of CJEB and R.D. Calkins Professor of International Business Emeritus at Columbia Business School, greeted attendees and set the tone of the conference. He expressed optimism about the global economic system despite many current geopolitical challenges. He elaborated on the twin topics of the conference: financial technology (FinTech) innovations in Japan and beyond, and the political and economic relationship between the U.S. and Japan. CJEB selected Japanese financial technology for examination because of recent innovations that have led to ongoing major transformations in the industry.
He thanked Nobuchika Mori, commissioner of Japan’s Financial Services Agency and a long-time friend of the Center, for joining as keynote speaker on this topic.

In introducing the second conference topic, Professor Patrick expressed concerns about the Trump administration’s foreign policy and attitude toward free trade. He noted that the U.S.-Japan economic relationship and security alliance is strong, and credited Prime Minister Shinzo Abe and Deputy Prime Minister Taro Aso for striving to maintain vital connections between the two countries. Professor Patrick thanked Ambassador Alan Wolff, chairman of the National Foreign Trade Council, for joining as a keynote speaker on this topic.

**Keynote Speech: Will FinTech Create Shared Values?**

David E. Weinstein, director of research at CJEB and Carl S. Shoup Professor of the Japanese Economy at Columbia University, gave a warm welcome to keynote speaker Nobuchika Mori, Commissioner of the Financial Services Agency in Japan. Professor Weinstein noted that he has known Mr. Mori for many years and considers him one of the leading thinkers in the world on financial regulation. He pointed to Mr. Mori’s widely respected work supervising financial institutions, directing legislative planning, modernizing monitoring systems for financial institutions, promoting more robust capital markets under Abenomics, and encouraging policies to ensure financial stability and enhance economic growth in Japan.

Mr. Mori began his keynote speech by explaining that he would address the recent and potential developments in FinTech by posing six major questions. He noted that while he would use his keynote speech to go into detail on each question, he did not strive to provide definitive answers about the nature of FinTech or its future because the type of innovation that was happening in the industry had never before been imagined and could not be predicted.

The first question Mr. Mori addressed was whether the ongoing changes in FinTech were truly tectonic. He explained that the continuing digitalization of individuals’ daily interactions, through advances in internet and mobile technology, has long been creating an environment ripe for FinTech. This digitalization revolution has moved the future of customer-business relationships from one in which the interaction is intrinsically limited to the information conveyed through conversation, and in which the businesses largely dictate the terms, to one in which businesses can readily gather information about the customer to best tailor such relationships. Mr. Mori noted that there were limits to the access financial
businesses had to customers, but that those limitations were quickly disappearing as more customer information was being made available online, and better artificial intelligence was being developed to analyze and use this information. In an era in which many people find their mates on the internet and socialize and plan social engagement through websites, the amount of data that can be used to create personalized bespoke products and services is almost endless.

The second question Mr. Mori addressed was how much shared value, between customers and businesses, was being created by new FinTech. He gave the example of consumer finance companies currently offering loans to high-credit score customers based on limited digital information gathered, such as job and credit history. However, as FinTech further develops, the variety of financial and non-financial services offered will increase rapidly. As companies learn to re-bundle financial services to create cross-entry incentives to the customers, the potential for shared value will grow.

The third question has to do with who will be the key players as FinTech continues to develop. Will they be financial institutions, FinTech firms, or other entities with customer access and information? Mr. Mori noted that current trends in the financial institution structure depend on physical locations and expensive and complicated infrastructures. He argued that the ongoing changes spurred by FinTech might undermine institutions mired in older infrastructure models and allow room for new players to utilize competitive advantage. Mr. Mori gave as examples companies like Amazon and Rakuten, which have far greater access to customer information and will likely be better situated to gain knowledge and therefore business from customers.

As the FinTech advancements become more complicated, there is also a chance that customers will start searching for players in the industry who seem to have the most expertise, and customers will choose to entrust these players to guide their decisions, the same way that a patient trusts a doctor to make informed recommendations. If financial institutions are to remain relevant, Mr. Mori hypothesized that they would have to partner with outside parties, move quickly to take advantage of their existing strengths to create new avenues of business, and rely on their ability to convince customers that they are trustworthy.

The fourth question is of particular interest to regulators, and addresses the structure of supporting networks between customers and financial institutions. Currently, banks and insurance companies serve as hubs, and customers come directly to institutions to engage in a defined and limited set of transactions. However, as the industry changes, it is possible that companies will be formed that serve as intermediaries between a variety of different industries and a body of customers. The customers will be given a combination of financial and non-financial services through intermediary or interface companies.

Alternately, exchanges could be formed in which customers can skip an intermediary and instead access a variety of services either directly or with the help of a facilitator. Mr. Mori hypothesized that the financial
system will accommodate a number of different coexisting models, thus coming to resemble a capital market more than a typical banking system.

The fifth question addresses the role of financial regulators. As FinTech develops, so does the potential for competition, innovation, and greater shared value. Regulators must decide how to protect financial stability, create a level playing field, and manage conflicts of interest. Mr. Mori stated that in order to facilitate the bundling and unbundling of functions, regulators might shift their focus from entities performing the functions to the functions themselves. This approach will facilitate a wider scope of entities to perform a wider scope of functions, while keeping the focus of the regulators on the aspect of business transactions that is most sensitive for customers. Mr. Mori noted that, in order for this new style of regulation to gain traction, and for true innovation to occur, companies will need leeway to experiment, and customers will need time to grow accustomed to innovations.

The sixth and final question Mr. Mori posed related to the ultimate goals and principles of regulators. The digitization of human life and the advance of FinTech will intersect in ways that will always present new issues to regulators. Mr. Mori wondered if it would be possible to have guiding principles on how to approach FinTech and digitization, rather than to address each emerging issue ad hoc. If so, Mr. Mori posited that the principles should be founded on the ultimate goal of promoting national welfare by contributing to the sustainable growth of the national economy and wealth. Furthermore, he stated that regulators should work to facilitate the growth of players who win customer confidence. Finally, in finding a balance between protection and excessive intervention, regulators should also be mindful of encouraging financial institutions to be forward-thinking.

In conclusion, Mr. Mori stated that there were many other questions that need to be addressed as the development of FinTech progresses. He reaffirmed that the attitude of the Japan Financial Services Agency should be as innovative as the industry players, and that one must not be averse to asking questions that cannot yet be answered.

Panel I: The Future of Japanese Financial Services and Industry with FinTech

Left to right: Masaaki Tanaka, Yutaka Matsuo, David Asher, Yuko Kawai, Takatoshi Ito

Takatoshi Ito, associate director of research at CJEB and professor at the School of International and Public Affairs at Columbia University, served as moderator for this panel. He began by introducing the panelists in the order that they would speak: Masaaki Tanaka, senior global advisor at PwC International; Yutaka
Mr. Tanaka began his presentation by explaining that he and his company, PwC International, are dedicated to tracking the radical changes FinTech is introducing to the traditional financial services industry. As an example of the dynamic innovation FinTech can provide to everyday customers, Mr. Tanaka compared a new FinTech-driven service for international currency exchange with a traditional banking method of currency exchange. The FinTech model was far cheaper and easier to use than the traditional model. Mr. Tanaka explained how this simple example is representative of the larger disruptive power of FinTech, a conclusion that was also supported by a survey conducted by PwC of over 1,300 worldwide senior financial services and FinTech executives.

Mr. Tanaka discussed the recent growth of global FinTech and explained that the emergence of open-source frameworks, scaled cloud computing, and on-demand developers has substantially lowered the capital and knowledge barrier needed to enter the FinTech space. He explained that this growth had led survey respondents to claim that they were concerned about losing revenue to innovators, that they recognized the need to embrace the disruptive nature of FinTech, and that they expected to increase FinTech partnerships. Mr. Tanaka noted that Japan was currently lagging behind the global level of current partnerships between financial institutions and FinTech, but that Japanese survey participants expressed an above global average expectation to increase FinTech partnerships over the next three to five years.

While there seems to be a strong global consensus that FinTech integrations are a current and future necessity, Mr. Tanaka noted that there are many challenges that will have to be overcome, including IT security, regulatory uncertainty, and international differences in management, operations, and business models. Furthermore, he explained that incumbent financial institutions are not as well set up as FinTech organizations to adopt innovation and adapt to change. For example, while a high percentage of FinTech organizations is exploring and engaging emerging technologies such as blockchain currency, artificial intelligence, and biometrics, a much lower percentage of large financial institutions is pursuing the same technologies.

Examining the reception of FinTech in Japan in particular, Mr. Tanaka found that Japanese companies typically invest far less in FinTech than the global average, and they expect a far lesser annual return on investment in FinTech projects. Describing Japan’s attitude as more focused on defense than offense, Mr. Tanaka explained that Japanese financial institutions
were slower in adopting digital channels to interact with customers.

In conclusion, Mr. Tanaka noted that the financial services industry will undergo dramatic changes in the coming years. Financial players will benefit from an open, evaluative, and partnership-oriented approach to innovation while concentrating on the customer’s voice and fostering a company and IT culture that supports innovation.

Next, Yutaka Matsuo spoke broadly on the topic of artificial intelligence. He began with an anecdote about an international championship for the game of “Go.” One player recently won more than 50 straight games against the world’s top players, and it turned out that it was not a human player but rather Google’s AlphaGo AI. He noted that this discovery shocked many and helped fuel a new boom of interest in AI.

Professor Matsuo noted significant recent advancements in AI, such as the advent of AI’s ability to accurately recognize images. He explained that AI image recognition now surpasses the average accuracy of human image recognition. He noted that this particular development will be fundamental to the automation of industries that have not been able to be automated thus far, such as certain sectors of agriculture, construction, and food preparation. Professor Matsuo compared these developments to other major developmental phases in the history of this planet’s inhabitants that have led to the diversity of species. Referring back to the idea of image recognition, he gave the example of the evolution of eyes that allowed animals to progress rapidly in ability acquisition and survival mechanisms. Professor Matsuo emphasized that Japan should be a leader in developing AI and could access great global opportunities in a number of fields.

Specifically in relation to how AI can play a role in FinTech and support innovations in the financial industry, Professor Matsuo returned to the importance of image recognition. AI can be used to check damage for insurance claims, can assist or replace traders in examining data charts, and can not only collect data and interact with customers, but also foresee outcomes and risk, and can identify opportunities. He concluded with the hypothesis that AI might even be able to do the job of economists, but not, he assured the audience, for many years to come.

Next, David Asher explained how he came to be involved in the field of AI when he helped develop financial intelligence systems for the U.S. government. His current work with SparkCognition, which he explained is the fastest growing artificial intelligence company in American industry, has prompted him to work with hedge funds and examine how AI is transforming finance and asset management. In his estimation, machine-driven analysis and strategies are dominating the field and have far outperformed raw discretionary strategies. AI is already being put to work in financial markets to
predict, simulate, identify, analyze, and automatically trade at massive scale. Mr. Asher explained that, while quantitative funds only represent 15% of hedge funds, this percentage steadily grown, and the quantitative funds, especially those driven by AI, strongly outperform other funds.

Mr. Asher delved further into the question of what AI is, explaining that, like the human brain, AI turns data into insight by processing information, drawing conclusions based on previous insight and continual new data, and then translating this data into learning and communicating it in natural language or other forms of expression such as color coding. He explained that AI uses scenarios to develop models and create predictors to help prepare for economic downturns and other changes and shocks.

In closing, Mr. Asher touted the robustness of AI in providing information in context with a small footprint and a maximized impact. He explained that the possibilities for AI include scenarios in which you could ask what company today most looks like Apple in 2001, or make predictions for the future based on data gathered from the recent past, or view different possible macroeconomic outcomes based on various hypothesized data.

Yuko Kawai then spoke about the challenges of developing FinTech in Japan, a country that is still primarily a cash-based society. She noted that the outstanding amount of cash is equivalent to 20% of Japan’s GDP and that while many individuals have credit cards, they do not use them as often as international peers in retail situations. Regarding wholesale, she noted that many small- and medium-sized corporations do not take digital payments, and that many transactions between businesses are still done through transactions at physical locations such as banks and ATMs rather than internet banking.

Despite these challenges, Ms. Kawai noted several major developments in digital money in Japan, such as the use of prepaid cards, especially those issued by transportation companies, as well as increasing credit card payments made by foreign tourists.

As a representative of the Bank of Japan, Ms. Kawai noted her focus on the structure of banks, which typically have massive legacy systems that require a major IT investment as well as major funding. However, she noted that there are no major new IT companies (like Alphabet, Facebook, or Microsoft) that would normally be tapped to lead innovations away from legacy systems.

Ms. Kawai noted that here has been an influx of startup companies introducing FinTech services to Japan including cloud accounting, digital wallets, bitcoin, and web-based cloud financing. She stated that in order to predict future developments, Japan needs to identify the major issues that need to be solved in order to facilitate greater progress in FinTech. Three major areas she identified are the productivity of small-sized firms, the productivity of banks, and the improvement of the user experience. In closing, she noted some open questions for the future including whether bank legacy systems can be transitioned to more flexible systems, whether user digitalized data can be made secure, if Japan should promote the digitalization of individuals and corporations, and if the world becomes fully digitalized, what is the role of the central bank in this context?
Keynote Speech: The U.S.-Japan Relationship and American Trade Policy

Professor Patrick introduced Ambassador Alan Wolff, chairman of the National Foreign Trade Council, former U.S. Deputy Trade Representative, and senior counsel at Dentons US LLP. He noted that the political climate in the United States following the election of Donald Trump necessitated a particularly careful selection of a keynote speaker to represent an American perspective. He and the rest of the CJEB professors wanted someone who was particularly knowledgeable, sophisticated, politically savvy, and balanced in judgment. Professor Patrick expressed the Center’s delight that Ambassador Wolff accepted their invitation and, after listing the speaker’s many illustrious professional and political appointments, invited the audience to join him in welcoming Ambassador Wolff. He noted that a full version of Ambassador Wolff’s presentation would be available on the CJEB website immediately following the conference.

Ambassador Wolff began by sharing his professional experience as a player in U.S.-Japan relations, noting what a pleasure it had been to witness how U.S.-Japan trade has evolved from a relationship mired in conflict to one where the two countries share the same vision. He expressed cautious optimism that this close trade relationship would continue under the current administration. He explained that the potential for ongoing strong ties could be examined by looking at four different historical periods in U.S.-Japan relations.

The first period, extending from the 1970’s to the late 1990’s, was one of ongoing friction. Ambassador Wolff noted that the 1970’s was a particularly challenging decade for international economic harmony because the United States had come to develop a strict and fixed set of policies, driven by the country’s trade deficit. The United States saw Japan as playing a major role in the deterioration of the U.S. trade balances, and President Nixon imposed import surcharges and trade barriers that strained relations with Japan. Some officials in Japan viewed the alliance as imbalanced, claiming that the United States demanded Japan follow its lead without reciprocity. In contrast, some U.S. officials, including Ambassador Wolff who was then in the U.S. Treasury Department, viewed the alliance as potentially facilitating a reciprocally open Japanese market. The efforts to manage bilateral trade problems occupied both countries’ trade negotiations for the next quarter-century.

In the 1980’s, relations became even more turbulent, particularly due to the flood of Japanese cars into the U.S. market. As a result of this U.S. demand, Japanese carmakers decided to start producing cars in the United States. The investments these companies made in the United States eventually helped ease trade relations between the countries.
and helped build the foundation for a strong bilateral relationship.

The 1990’s opened with continuing bilateral trade fiction but soon the tensions crested, opening a path to greater harmony between the two countries. This positive development soon moved, conversely, into a period in which the United States progressively reduced its focus on and interest in trade relations with Japan.

The next period of U.S.-Japan relations was the early twenty-first century. Ambassador Wolff explained that indifference to Japan trade in the United States continued well into the first decade of the century. However, after President Obama announced that the United States would join the Trans-Pacific Partnership Agreement (TPP), and Japan followed suit four years later, U.S.-Japan relations began to improve. Ambassador Wolff explained that Japan played a constructive and confident leadership role in developing the rules of the TPP, and that the agreement was a remarkable accomplishment for all parties involved. This good relationship continued until President Obama announced that Japan would join the TPP, and the United States from the agreement soon after his inauguration.

Ambassador Wolff then began his analysis of the third period of U.S.-Japan relations, starting with the era of President Trump. He noted that the administration has had a fractious start, and U.S. partnerships with a number of historical allies were almost immediately challenged. However, he stated that Prime Minister Abe did a brilliant job managing the U.S.-Japan relationship by successfully meeting twice with President Trump. Deputy Prime Minister Aso followed up by orchestrating a successful reception for Vice President Pence in Tokyo. As a result of these efforts, Japan felt confident that it could still engage in discussion with the remaining members of the TPP. Furthermore, Abe and Aso established the possibility that Japan and the United States will be able to continue discussions that may eventually lead to a bilateral trade agreement between the two countries.

Ambassador Wolff explained that under President Trump, U.S. trade policy has become increasingly and openly protectionist, focusing strongly on exports with a tendency toward unilateralism. In this context, with multilateral trade associations off the table, the best option for trade with the United States is through bilateral trade agreements. Ambassador Wolff argued that Japan is the clearest major candidate for bilateral trade agreements with the United States.

Finally, Ambassador Wolff took a moment to address the future of U.S.-Japan relations. He noted that there is no strong indication as to what the Trump administration will do when it comes to trade relations with Japan. However, if bilateral negotiations are to begin, Japan would have to address the U.S. deficit with Japan in merchandise trade, as well as other trade issues. Furthermore, TPP will continue to play a role in any bilateral trade relationship with the United States, if only because all trade relations will exist within the same broad framework of global challenges.
In closing, Ambassador Wolff reiterated his firm belief that the United States and Japan can form a unique and remarkable partnership.

Panel II: U.S.-Japan Economic Relations under the New U.S. Administration

Professor Weinstein served as moderator for the second panel, which focused on the aftermath of the unexpected 2016 election and the question of how the Trump presidency would impact the U.S.-Japan relationship. He introduced each of the panelists in the order they would speak: Akihiko Tanaka, president of the National Graduate Institute for Policy Studies; Merit E. Janow, dean of the School of International and Public Affairs and professor of professional practice in international economic law and international affairs at Columbia University; Gerald Curtis, Burgess Professor Emeritus of Political Science at Columbia University; and Ambassador Wolff.

Professor Tanaka explained that his presentation would focus on the international security aspect of the U.S.-Japan relationship under President Trump’s new administration. After President Trump announced during his campaign that he wanted to review the security alliance between Japan and the United States, Professor Tanaka began to wonder if there would be a fundamental shift in the relationship between the two countries. However, the relationship has not changed. President Trump has reinforced traditional U.S. support of the alliance, and the members appointed to President Trump’s cabinet have followed suit. Professor Tanaka attributed this continuation of a strong alliance to Prime Minister Abe’s strategic negotiations with President Trump.

He noted that a predominant theme in the relationship between the United States and Japan is how to deal with North Korea. This has been a sensitive and ongoing issue for all players in the region, and it has become increasingly pressing as North Korea continues to develop its nuclear weapons program and regularly launches test ballistic missiles. Professor Tanaka noted that the Obama administration’s tactic of largely ignoring North Korea has had no effect on curbing the country’s weapons program, and that the issue has now reached a crisis point. He hypothesized...
that after North Korea started to develop capabilities to launch a nuclear-armed missile within range of the United States, the approach to North Korea is likely to change. He noted that these recent developments have strengthened the alliance between the United States and Japan as well as brought closer cooperation with China.

Professor Tanaka also addressed how these changes in security alliances would likely effect economic partnerships. He posited that the more tension there is in areas of international security, the more likely security partners are to facilitate positive economic relations with each other. He noted that the increased cooperation between the United States and China when it comes to North Korea is likely to lead the United States to make more compromises in its trade position with China. He wondered if this had the potential of negatively affecting U.S.-Japan economic relations.

Regardless, he concluded, now is the time when the United States, Japan, China, and South Korea should cooperate regarding the North Korean threat.

Dean Janow began her presentation by posing the question of whether we have now seen a sea change in international relations, or whether the recent developments will only last until the end of the Trump administration, after which relations will revert to a more familiar, historical status quo. While noting that she did not have an answer to this question, she pointed out that the current anti-trade sentiment seemed to have long roots. For example, international trade featured prominently during the 2016 U.S. elections and none of the candidates was pro-multilateral trade.

Dean Janow went on to note that the current level of political divisiveness could no longer be explained by traditional party differences. She noted that some have attributed the contemporary political unrest to a rise of populism, but she thought it had more to do with tensions relating to globalization, automation, changes in the work force, and the perception of stagnation in wages and inequality. She emphasized that this disquiet must be viewed side by side with the incredible technological advancements that have been happening in areas like precision medicine, computational sciences, and FinTech. She noted, for example, that while the digital economy is causing great anxiety and altering political discourse in the United States, it is also creating enormous opportunity.

Dean Janow discussed how the current administration’s policy response to the digital economy has not yet been reassuring. While it is encouraging that some of the more extreme statements President Trump made while on the campaign trail have not come to pass, there is also no real indication of what trade policy under his administration will be. However, based on the executive orders issued and the trade cases argued, one can glimpse some of the potential future developments in trade policy. Professor Janow
pointed to several advertised Trump ideologies that concern her, including the “Buy American, hire American” philosophy, which she thinks will not benefit America in the long run. She noted the good reasons for the longstanding American tradition of frowning on government procurement as a tool of industrial policy.

Dean Janow concluded by saying that she thought the FinTech portion of the conference was a matter of great interest in the U.S.-Japan trade relations discussion and that there was great potential for bilateral discussion of FinTech as America and Japan move forward and examine opportunities for collaboration and innovation.

Professor Curtis examined the political climate in America that made it possible for Donald Trump to be elected president, how this political climate has roots in and consequences for its global context, and what is next for the U.S.-Japan relationship. In addressing the electoral success of President Trump, Professor Curtis pointed to working-class Americans who are dissatisfied because the government is not protecting them from the negative effects of globalization, such as growing inequality, declining living standards, and unemployment. Professor Curtis did not blame this dissatisfaction on either major party, saying that both are deeply dysfunctional and unprepared to take the country into the future.

Professor Curtis emphasized the importance of the change in the attitude of the Americans about America’s role in the world. He claimed that previous overwhelming confidence in America’s global leadership has been steadily eroding. Though President Trump is not going to single-handedly break with past American foreign and economic policy, his rejection of multilateral trade agreements like the TPP and his view that free trade has hurt American workers has broad support among the American public.

Regarding the U.S.-Japan relationship, Professor Curtis noted that Prime Minister Abe’s handling of his meeting with President Trump was a great success for Japan. Prime Minister Abe was able to develop a close personal relationship with President Trump and get him to walk back the anti-Japan rhetoric he repeated on the campaign trail. He convinced Trump to initiate a bilateral economic dialogue led by Deputy Prime Minister Aso and Vice President Pence with a mandate to seek avenues for cooperation rather than focus on sectoral disputes. Pence is seen by Japanese as being friendly to Japan and to Japanese business because of his success as Indiana governor in attracting Japanese investment. Professor Curtis concluded by reiterating that the U.S.-Japan bilateral relationship was strong and that the challenge the two countries face is how to work more closely together to foster peace, stability, and prosperity in East Asia and globally.

Ambassador Wolff offered closing comments for the panel. He emphasized the importance of trade for security and security for trade. In analyzing this last U.S. election, he noted that polls show that
youth are overwhelmingly in favor of free trade, and he expressed optimism that the future might hold better hope for trade relations. Finally, he revisited the many ways Japan and the United States can collaborate, giving examples including FinTech, cyber security, cancer research, and infrastructure development.

**Closing Remarks**

Professor David Weinstein concluded with closing remarks and gave special thanks to the speakers, moderators, audience members, and corporate sponsors, for contributing to this very successful and interesting event. He also thanked the Development Bank of Japan for co-sponsoring this conference by allowing CJEB to use their conference facilities. He welcomed all the attendees to the reception afterwards.