

U.S.-Japan Relations in a New Era: Trade, Governance, and the Global Economy



*Top row, left to right: Drew Edwards, Hiroki Sampei, Alicia Ogawa, Mireya Solis, Lorenzo Caliendo, Shotaro Oshima
Bottom row, left to right: Glenn Hubbard, Takatoshi Ito, Hugh Patrick, David Weinstein, Merit Janow*

CJEB's annual Tokyo conference
Otemachi Financial City Conference Center, Tokyo, Japan
May 28, 2019

Welcoming Remarks

The Center on Japanese Economy and Business (CJEB) held its annual conference in Tokyo on May 28, 2019. This conference supports the Center's overall mission to promote knowledge of Japanese economic, political, and business systems in domestic, East Asian, and international contexts. This year's conference was titled "U.S.-Japan Relations in a New Era: Trade, Governance, and the Global Economy." It was co-sponsored by the Development Bank of Japan.



Hugh Patrick

Hugh Patrick, Director of CJEB and R.D. Calkins Professor of International Business Emeritus at Columbia Business School, welcomed the attendees and spoke about Japanese current affairs, including the imperial abdication, the beginning of the Reiwa era, the pending increase in consumption tax, local and upper- house elections, and President Trump's recent state visit. Professor Patrick emphasized the overall wellbeing of both the Japanese and the American economies, as well as the continued strong relationship between the two countries as political, security, business, and economic partners. He also discussed the fundamental strength of the current global economic system despite such disquieting international developments as Brexit, ongoing difficulties in the Middle East, conflicts with China, and threats posed by North Korea.

Professor Patrick outlined key topics the 2019 conference would cover, including U.S.-Japan trade negotiations, increasing protectionist policies in many global sectors, and President Trump's role in the current geopolitical unrest.

In closing, Professor Patrick thanked the CJEB corporate sponsors and staff, and noted that he would soon be taking on a new, active role at CJEB as Chairman. Professor David Weinstein, currently Director of Research at CJEB, would succeed Professor Patrick as Director of the Center starting July 1, 2019.

Keynote Speech: The Economics of Trump and the G20 Summit

Glenn Hubbard, Dean and Russell L. Carson Professor of Finance and Economics at Columbia Business School, began by agreeing with Professor Patrick's analysis that the economic relationship between Japan and the United States is both strong and of continuing importance. Specifically regarding trade, Dean Hubbard noted that the two countries share a rich history of partnership, briefly giving the example of the Kikkoman Company and its investment in America's heartland. Dean Hubbard explained that the main goals of his keynote address are to provide context for the current U.S.-Japan relationship, particularly in the era of President Trump, and then to examine recent and potentially upcoming major political and economic changes in G20 countries, spurred by technological developments and international trade.

Dean Hubbard outlined what he saw as the recent successes of President Trump's policies, including a resetting of growth expectations in the United States as



Glenn Hubbard

well as the enactment of tax and regulatory changes specifically aimed at growth. He noted that President Trump's actions on trade were more controversial, particularly when his policies could be construed as harmful to relationships with key allies like Japan. In comparison, Dean Hubbard described Japan's recent and current trade policies and actions as helping Japan rise to the global stage as an architect and defender of free trade.

In examining how approaches to international trade can either help or hinder growth in an economy, Dean Hubbard noted the importance of considering the role of domestic political concerns and public support for dynamic change. While free trade policies can create growth, growth is never consistent across all industries, and this generates job and wage concerns unsettling to the general population and to voters. When this anxiety is not properly addressed domestically, it can lead to international tensions, as can be seen in the modern day U.S.-China relationship, and can produce turmoil in global economic markets. Such international economic unrest can in turn diminish improvement in productivity growth, which Dean Hubbard explained is essential to economic growth in the U.S., Japan, and other G20 economies. A decrease in productivity growth can in turn diminish living standards. Dean Hubbard was optimistic that the upcoming G20 summit meeting would offer an opportunity for global reflection on growth prospects, financial stability, international trade relations, and sources and consequences of populism.

Turning to a closer examination of the trade tensions between the U.S. and China, Dean Hubbard said that President Trump has been rightly criticized for focusing so heavily on America's bilateral trade with China. However, he stated that President Trump has been correct in calling China out for its unfair trade practices and its approach to intellectual property (IP) and technology transfers. Noting that tariff brinkmanship does not benefit either country, Dean Hubbard suggested that all leading industrial economies should focus more on their own domestic capabilities and government support for research and collaborations on technological advancement. In addition, he surmised that trade rifts would prompt a G20 discussion on how better to advance an open trading system and should prompt the U.S. to reconsider participating in the Trans-Pacific Partnership (TPP).

Next, Dean Hubbard discussed technological change, which he described as the other major disruptor of advanced economies and labor markets. Like trade, technology creates opportunities for productivity growth and new jobs, and also like trade, technology can create turmoil in industries and jobs categories. G20 economies face the challenge of how to develop and maintain public support for technological change while acknowledging that such change is not always uniformly beneficial to all.



Glenn Hubbard and Hugh Patrick

The economic results of global trade and technology disruptions have political consequences that have recently led to increases in public populist concerns. Dean Hubbard noted that productivity booms tend to delay the emergence of new technology, and he emphasized that governments need to develop better policies to address disruptions in the labor markets and make it clear that change leads to a betterment for all. If the government's approach to worker dislocation is not well designed, it can signal a disinterest in mass prosperity and further fan the flames of populism.

Finally, Dean Hubbard encouraged G20 leaders to use what he termed a "GPS" guide to confront challenges from globalization and technological change. GPS stands for "Growth, Preparation, and Support." "Growth" means that there continues to be an increasing number of workers with the ability to work. "Preparation" means that governments must help train these workers. "Support" means that governments must assist lower-wage individuals through actions like tax credits and subsidies. This type of three-prong approach can be carried out individually in each country but sharing best practices will be key for bolstering a future of inclusive growth and mass prosperity. Dean Hubbard called upon participants at the upcoming G20 meeting in Osaka to emulate Japan's leadership and discuss ways in which openness and technological change can ensure that prosperity growth leads to mass prosperity.

Panel I: America and the New Protectionism



Left to right: David E. Weinstein, Lorenzo Caliendo, Shotaro Oshima, Mireya Solís, Merit E. Janow

Merit E. Janow, Dean of Columbia University's School of International and Public Affairs, opened the panel by introducing the speakers and giving her own thoughts on recent developments in international trade, noting that today's trade policy needs to be put in the U.S. historical context. Dean Janow drew on the work of economic and trade historians to observe that trade policy has had a divisive history but also has required bipartisanship to achieve success. It has served as an instrument to raise revenues for the government, to restrict imports, and to conclude reciprocity agreements. Historical shifts in trade policy have often been disruptive, not wholly unlike the current shifts. However, bilateral trade agreements, such as those between the U.S. and Japan, were generally pursued while also expanding multilateral agreements. The current U.S. aversion to multilateral, WTO-based rule expansion, especially the dispute settlement Appellate Body process, coupled with its unilateral trade actions, is rather unique. This posture likely results from many factors: the pressures of globalization and technological change, the economic role of China, and disappointment with the WTO (World Trade Organization). Thus, Dean Janow noted that President Trump's approach to trade has some characteristics carried over from other administrations, and other characteristics that are very unique to this Administration. Noting what she characterized as a crisis in the current WTO, she urged international leaders to consider those dimensions

of multilateralism that are important and to come together to discuss what can be done to catalyze reform and to strengthen the system.

Mireya Solís, director of the Center for East Asia Policy Studies and Philip Knight Chair in Japan Studies at the Brookings Institution, began her presentation by noting that the original architects of the multilateral trading system vowed to put an end to economic nationalism, which they saw as undercutting growth and fostering inter-state frictions. Expressing concern that their efforts had been in vain, Dr. Solís explained that her presentation would address thoughts on where the contemporary trend toward protectionism originated, the consequences of America's inward facing trade policy, and the prospects for the U.S.-Japan bilateral trade partnership.

Dr. Solís noted three major reasons for the current systemic crisis in the free trading system: the weakening of the negotiating and enforcement capabilities of the WTO; China's recommitment to a state capitalism model with market distorting policies such as IP theft, over-subsidization, unfairly advantaged state-owned enterprises, forced technology transfers, and digital protectionism; and the "America first" focus of the Trump administration.

In regard to America's inward facing trade policy, Dr. Solís explained that the American withdrawal from TPP and the American use of national security excuses for imposing tariffs on allies and partners have significantly diminished U.S. influence in Asia. Further damage could result from a potential mishandling of bilateral trade talks with Japan.

Dr. Solís noted that the bilateral trade talks between the U.S. and Japan would not be a replay of the TPP negotiations, because the U.S. and Japan moved on and in different directions in the few years since the original TPP was discussed. For example, although many were concerned about Japan's past indecisiveness in trade policy, it was Japan that ultimately played a key role in rescuing the TPP after the U.S. exit. She predicted that when the two countries come together to negotiate trade relations, Japan will focus on deflecting U.S. unilateralism, and the U.S. will focus on catching up to Japan's trade leadership by seeking better access terms for American farmers. There are many ways in which these negotiations can fall apart, and there is much at stake, but if done successfully, the negotiations can serve as a stepping stone toward coordinated economic statecraft.



Mireya Solís



Shotaro Oshima

Shotaro Oshima, chairman of the Institute for International Economic Studies, spoke next, explaining that his presentation's goal was to give historical perspective to contemporary issues in international trade. Agreeing with other conference speakers that the WTO was in a state of upheaval, Ambassador Oshima said it was worthwhile to look at the WTO's precursor, the General Agreement on Tariffs and Trade (GATT). He explained that the main goal of GATT was to foster liberalization of markets both domestic and international. He said that the country that benefited most from GATT arguably was Japan.

However, while, Japan's participation in GATT led to strong GDP growth in Japan, it also led to trade friction with the United States. Japan in response cooperated with the U.S. and others to create the WTO, expanding

GATT by including in its coverage services and trade-related IP as well as effective dispute settlement mechanisms.

Further discussing the current difficulties the WTO is facing, Ambassador Oshima noted that, unlike GATT, the WTO has been stymied in its attempt to further liberalize and formulate new rules in order to be relevant to the changing world economy. It has thus failed to be a living agreement. Instead, in its current state, it has become a hibernating agreement and is currently in need of reform.

Lorenzo Caliendo, professor of economics at Yale University, began his presentation on protectionism and industrial location by showing how trade has changed across the world over the last forty years. He explained that during that time, trade openness doubled in the world, almost doubled in Japan, grew almost three times in the U.S., and increased almost seven times in China. This phenomenon relocated industries and labor, led to aggregate welfare gains, and had distributional consequences. Another effect of trade openness has been an upsurge in American protectionism, with significant tariffs raised on imports, leading to retaliatory tariffs.



Merit E. Janow

In describing the effects of protectionism, Professor Caliendo first questioned whether protectionism actually brings industries and production back home and, second, whether bringing industry and production back home is actually beneficial. He then outlined several of the reasons behind trade protectionism. For example, some policies aim at manipulating prices of imports and exports to the benefit of certain political or industrial parties. Therefore, although the public focus may be on how tariffs bring back jobs, the true reason for trade manipulation may be because powerful industries or individuals benefit from price inflation and have worked to motivate politicians to enact the tariffs.



Lorenzo Caliendo

Professor Caliendo then spoke about some of the more practical reasons for moving industries from one country to another, including location in relations with trade partner countries, cost of local labor, and capital and value chain assets. Motivations also abound for not relocating an industry, such as the cost of relocation and rebuilding infrastructure. Although protectionist measures can encourage industries to move from one country to another, industries may still decide not to move because on balance the move is not worth other expenses or inconveniences.

In examining where factories are currently located across the world, Professor Caliendo noted that, while the majority are in China, the U.S. is not that far behind. However, the locations of U.S. factories are concentrated in only several states, including California and Texas. Based on this knowledge and the potential of the U.S. increasing tariffs to 25% from the average initial level of

about 3.5%, Professor Caliendo's research examines how manufacturing in the U.S. might change. (He noted that his research did not factor in retaliatory tariffs from China.)

In the short run, Professor Caliendo predicted that the number of U.S. based factories would increase in areas with a larger manufacturing base, such as the Midwest. However, in the long run, due to competition between states and differing labor laws and restrictions, the majority of the newly founded U.S. factories would move out of these regions. As such, it is true that the number of factories will grow in the United States, but not in the areas traditionally expected to be building ground. In addition, when the number of U.S. factories does increase, it is likely that prices will also increase and U.S. wages will decrease, leading to a declining standard of living and wellbeing.



Left to right: Lorenzo Caliendo, Mireya Solis, David Weinstein, Merit Janow, Shotaro Oshima

David E. Weinstein, Director of Research at CJEB, spoke next, outlining his team's research on ramifications of the past two years of protectionist trade measures in the United States. He explained that in 2018, the U.S. imposed six waves of tariffs, dramatically increasing the average quantity of import tariffs in the U.S. and reversing decades of trade liberalization. In return, there has also been a steep increase in retaliatory tariffs.

The effects of such tariffs and of retaliatory tariffs have been numerous. Professor Weinstein examined the steep decline in all U.S. exports to China (paired with only a moderate decline in imports to the U.S. from China). Discussing the efficiency costs of protectionist tariffs, Professor Weinstein noted that in many cases, instead of discouraging customers from buying goods from abroad altogether, high tariffs may simply encourage customers to buy goods from tariff-free foreign countries, even at a higher rate than the original price they were paying. However, since customers now buy from a tariff-free country, none of the increased price paid goes to government revenue; it is just a straight loss to the country through increased prices.



David E. Weinstein

Similarly, Professor Weinstein's research showed that even under the relatively moderate 2018 level tariffs, the increased cost to U.S. households for tariff-imposed imported goods was significant. This cost, already not easy to bear, will more than double when 2019 total tariffs go into effect.

Next, Professor Weinstein examined what past tariffs, specifically related to steel, have accomplished for the United States. He noted that various administrations over the past several decades have instituted trade measures to protect the steel industry. However, steel employment has decreased during this period of "protection" because at the same time advancements in automation have diminished the industry's need for labor.

Another effect of the protectionist trade practices has been an increase in product prices, including those for appliances like washing machines. For one, the cost of making washing machines domestically has gone up due to the cost of importing steel. On top of that, now that fewer machines are being imported due to tariffs, the lack of competition has also driven up domestic prices.

In closing, Professor Weinstein emphasized the negative effects of the Trump tariffs on the U.S. economy: U.S. consumers and importers bear 100% of the tariff increases, the rise in prices, the stock market's negative reactions, how retaliation hurts exports, and how uncertainty discourages investment.

Keynote Speech: His Excellency Taro Aso

Takatoshi Ito, professor at Columbia University's School of International and Public Affairs and Director of CJEB's Program on Public Pension and Sovereign Funds, introduced His Excellency Taro Aso, Deputy Prime Minister; Minister of Finance; Minister of State for Financial Services, Cabinet Office, Government of Japan, briefly outlining his many achievements.

Minister Aso began his address by reminding the audience that, despite recent turmoil, America still holds a place of global prominence and that many in the world still look to America for leadership. He explained that he frequently receives visits from Americans who express pessimism about the current state of American politics and about America in general. Minister Aso said that he thinks such pessimism is unfounded. He reminisced about his time as a student at Stanford University. Although he experienced many of the tragic events in America, including the assassinations of John F. Kennedy, Martin Luther King, and Robert Kennedy, he was always struck by the resilience of the nation and the "sky is the limit" attitude of its people.

He also noted that a strong America is key to a strong Japan, just as a strong Japan is in the best interest of America. He expressed confidence that the U.S. and Japan can work out any common challenges, including ongoing trade negotiations. Both countries have invested much in their relationship, including Japanese car companies' continuing investment in producing cars in America. He noted that since the



H.E. Taro Aso



H.E. Taro Aso and Takatoshi Ito

United States and Japan are like-minded partners, they have better prospects for working out not only short term challenges but also long-term concerns. Minister Aso also encouraged CJEB to continue facilitating research on the economic and political ties between the two countries.

Finally, Minister Aso illustrated several key changes now taking place in Japan, ranging from better corporate governance, to the fostering of young entrepreneurs, to rewriting social contracts to include more spending on families with children. He urged

the audience to pay attention to the changes going on in Japan.

Panel II: Shareholder Engagement: How Investors Talk to Companies



Left to right: Hiroki Sampei, Tsuyoshi Maruki, Akitsugu Era, Drew Edwards, Alicia Ogawa

Alicia Ogawa, Director of the Project on Japanese Corporate Governance and Stewardship at CJEB, initiated the second panel discussion by describing Japan's struggle to reform the shareholder-management relationship. While noting the difficulty of measuring the success of the reforms so far, she pointed to the general regulatory opinion that Japanese companies are indeed acting to implement reform but are often doing so without significant strategy or effectiveness. Professor Ogawa said that the U.S. system has also been less than perfect, particularly in preventing fraud and abuse or efficiently allocating capital. In this sense, U.S. companies have been too focused on the short term and on shareholders at the expense of the long term and other stakeholders. She stated that Japan is in the opposite situation and should become more accountable to shareholders and less concerned with other stakeholders.

Professor Ogawa expressed concern about Japan's potential overreliance on external, independent boards of directors instead of active oversight by shareholders. In addition, noting that simply enacting reform measures was not enough, Professor Ogawa recommended that Japanese companies change their focus to look at long-term strategies and examine how to embrace and benefit from the disruption that has come with oversight changes. She recommended that this can best be done through close partnership with investors and explained that she organized today's conference panel discussion as a way to open dialogue between Japanese companies and the types of investors who are interested in being active participants. In this way, it would be helpful to start a discussion about the types of questions investors would pose, the issues that are most important to them, and how they prefer to interact with management.



Alicia Ogawa



Drew Edwards

Drew Edwards, CEO and CIO at Usonian Investments, began his presentation by describing his organization as a Japanese equities investment firm with over one billion dollars in investments in Japan for clients that are mostly endowments, foundations, and pension funds. He described his firm's policy of approaching investment with the mindset of a long-term owner, regularly interacting privately and proactively with management teams with the hope of influencing investment outcomes. In the rare case that conflicts arise, he described his organization's tendency to react assertively to address counterproductive management initiatives. In addition, Mr. Edwards noted that many of the companies his organization works with are initially undervalued in the market, and Usonian strives to identify and address underlying causes of low market value, such as asset and operational inefficiencies and corporate governance issues. As a further example, he noted that many of the companies have assets and

intellectual property resources that they have not utilized to the fullest extent. In those cases, Usonian advises on how best to leverage these assets and resources. Usonian also engages with clients on strategic and operational topics. They introduce international alliance partners and acquisition targets and discuss with clients how to reallocate resources from low-value- to high-value- added business opportunities. Finally, they work with clients on corporate governance, occasionally suggesting director candidates to enhance board skillsets.

Akitsugu Era, director and head of the investment stewardship team at BlackRock Japan Co., Ltd., introduced his investment management firm, noting that BlackRock is listed in the U.S., manages over six trillion dollars, and has a diverse offering of mostly passive investment strategies. BlackRock is a global team with local presence, since the firm believes that to invest productively, regional and local market expertise is key. As such, regardless of the various global sources of investment, all proxy voting is handled locally in the region of investment. Mr. Era then discussed how BlackRock identifies companies for investment, focusing first on the potential impact of engagement by looking at probability for change, significance of issue, and size of holding. He emphasized the importance of building bridges of understanding and trust between companies and investors as a way of leading to influential engagements. He noted that both the number of meetings BlackRock takes on a yearly basis as well as the number of companies it works with has increased steadily. In addition, the market cap coverage of BlackRock's engagement for companies in TOPIX is currently over 50%. In terms of BlackRock's top priorities for engagement, not only in Japan but globally, Mr. Era listed the following: long-term strategy, quality and quantity of human capital, corporate governance, and climate change disclosure. He noted that it was not BlackRock's job to tell management what to do, but rather to ask management the right questions and support the type of management that can give thoughtful, convincing answers.



Akitsugu Era



Tsuyoshi Maruki

Tsuyoshi Maruki, President and CEO of Strategic Capital, Inc., spoke next, describing his fund management company as much smaller than either BlackRock or Fidelity and as having a different investment strategy. Unlike in other fund management firms, Strategic Capital actively exercises its shareholder's rights. Mr. Maruki explained that although sometimes management teams considered it rude, he insists upon meeting with management face-to-face and explaining their viewpoints frankly, including suggestions for changes in leadership based on performance or restructuring of assets. He also noted that while Strategic Capital often recommends mergers and acquisitions, it also does not have an aversion to companies that try to avoid being bought through "poison pill" style practices, because companies with "poison pills" declare that they are cheaply valued. Mr. Maruki explained that he requests in-person interviews with top management to discuss corporate governance and capital allocation

strategies, and uses a number of methods to follow up with recommendations such as writing letters, building websites, and placing advertisements in newspapers. He also noted the importance of meeting with independent directors, parent companies, and affiliated companies. Finally, he outlined what he thought of as some of the main challenges Japanese corporations face, saying that most managers of Japanese corporations do not understand that their main purpose is to maximize the return for shareholders.

Hiroki Sampei, head of engagement at Fidelity International, made the final presentation. He first addressed the question of how shareholder engagement has changed over time at Fidelity, noting that the total number of engagement meetings had increased threefold over the period from 2016 to 2018, with agenda topics focusing mostly on long-term strategy, capital allocation, and environment and social issues. He also noted that the number of meeting requests made by companies (rather than by Fidelity) sharply increased over the same period, showing how much companies value the proactive input of investors. In discussing how Fidelity measures success of engagement, Mr. Sampei outlined the time horizon from an initial engagement meeting to a mid-term analysis of whether the company has taken shareholder input seriously to a final output measured by corporate performance and share price performance. Next, Mr. Sampei discussed Fidelity's strategy for promoting value enhancement which examines a target company's unappreciated value when its market value is far below its reasonable fair value over a long period of time, or unacceptable value when a target company's return on capital is far below its cost of capital. This process involves a significant number of face-to-face meetings (rather than communication via letters), starting with a "Value Creation Diagnosis Report" developed by Fidelity as a method of clarifying key points and laying out evidence. He emphasized the importance of preparing the discussion paper to avoid miscommunication and change communication mode.



Hiroki Sampei

Finally, Mr. Sampei outlined some of Fidelity's proxy voting policies for Japan.

Closing Remarks



Professor Weinstein concluded the conference by thanking the speakers, the audience, and the Center's corporate sponsors. He extended special thanks to the Development Bank of Japan for its co-sponsorship of the program.

Finally, Professor Weinstein repeated Professor Patrick's announcement about the upcoming change in CJEB leadership, noting that he would become Director of CJEB on July 1, 2019, and Professor Patrick would become Chairman. Professor Weinstein praised Professor Patrick's many achievements since CJEB's founding in 1986, noting in particular how much the Center had done to help Americans understand Japan and vice versa. He expressed his great admiration for Professor Patrick, noting that in the field of Japan studies, graduate students hope to become professors, and professors hope to become Professor Patrick.

Reception Toast

Mr. Satoru Komiya, President and Group CEO of Tokio Marine Holdings, Inc. and former CJEB Visiting Fellow from 2016-2017, opened the reception with a toast. He spoke about his fond memories of the Center in his speech.



Satoru Komiya and Hugh Patrick