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SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR JAPAN AND THE UNITED STATES

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FINAL REPORT

2024 Symposium on Building the Financial System of the 21st Century: An Agenda for Japan and the United States

The twenty-seventh Japan-U.S. Symposium on Building the Financial System of the 21st Century was held in Washington, DC from November 21-23, 2024, soon after the Japanese Lower House election of October 27 and U.S. presidential and congressional elections of November 5. Sessions addressed the impact of the U.S. and Japanese elections on international finance and economic performance, major issues in banking and capital market regulation including the Basel III Endgame and ESG rules, prospects for soft economic landings in the U.S. and Japan, and the impact of AI on financial markets.

Topic 1: The Impact of the U.S. and Japanese Elections on International Finance

In Topic 1, participants discussed the impact of the recent U.S. and Japanese elections on international finance and politics. In the U.S., the reelection of former President Trump and the success of the Republican Party in controlling both houses of Congress were seen to presage significant changes in economic policy, financial regulation and supervision, diplomatic practice, and security policy. In Japan, the election had dealt a severe blow to the ruling Liberal Democratic Party (LDP)-Komeito coalition. Although Prime Minister Ishiba and the coalition remained in power as minority government, the administration lost its commanding majority in the Lower House and Ishiba had stayed on as Japan's leader only thanks to the abstention of the Democratic Party for the People (DPP) in the second round of the Lower House vote for prime minister. Discussion focused in particular on how the second Trump administration would approach fiscal, trade, and financial policies, and how that would affect the U.S., Japanese, and global economies.

Trump 2.0—Fiscal Policy

Participants anticipated that the return of Trump and a Republican Congress would have a significant impact on U.S. fiscal policy. In particular, there was a consensus that the new administration would successfully implement large-scale tax cuts in order to stimulate the economy and reduce the size of government. Participants agreed that the first order of business on the tax front would be to extend or make permanent the tax cuts legislated under the first Trump administration, which were scheduled to expire at the end of 2025. Some argued that this would not be highly stimulative, since they would not constitute new tax cuts and their extension had been widely expected. Others disagreed. They argued that the extension of temporary tax cuts would provide reassurance to investors and entrepreneurs that they would not face higher taxes and that demand would remain strong after 2025.

Participants also discussed whether further tax cuts would be put in place, as promised on the campaign trail. In particular, a number of participants anticipated that there would be proposals for corporate tax cuts, which some argued would support both short- and long-term growth by incentivizing investment. Some participants questioned whether significant corporate tax cuts would pass Congress, however. While Republicans clearly preferred lower taxes, they argued that fiscal hawks could balk at the impact on the budget deficit.

Supporters of further tax cuts considered three potential options for reducing the impact on the deficit. One was revenue from tariffs, which the Trump campaign had argued could pay for tax cuts. While participants expected that the administration would indeed impose a variety of new tariffs, many agreed that the additional revenue would be much less than had been estimated during the campaign. However, some felt that it could be one piece of the puzzle. Second, some participants argued that tax cuts could pay for themselves by stimulating higher economic

growth; if so, worries about "paying for" tax cuts were misplaced. Many participants were skeptical of that tax cuts would fully pay for themselves, based on empirical evidence from previous tax cuts in the U.S. and elsewhere. However, growth might mean that new tax cuts would not have to be compensated for entirely through new sources of revenue or spending cuts.

The third option, which received the most attention from participants, was the potential for significant spending cuts. A number of participants expressed optimism that spending cuts would be possible and applauded the establishment of the new Department of Government Efficiency (DOGE). Several argued that considerable savings could be made by reducing government headcount either through targeted reductions in employees or by eliminating unnecessary departments and agencies. It was also suggested that the new administration could save money by negotiating or capping drug prices paid by government programs like Medicare and Medicaid. Other participants were skeptical of the likelihood of large spending cuts. They noted that about three-quarters of federal government expenditures were non-discretionary, including interest payments, Social Security and government pensions, and health care, and that the Trump campaign had both pledged not to reduce Social Security and Medicare and also called for higher military spending. With the costs of entitlement programs expected to rise with the aging of the population, they expressed doubt that enough spending cuts could be found to make up for proposed tax cuts. Optimists argued that there was more fat to cut than many believed.

Participants agreed that one key question for all of the new administration's fiscal priorities would be political feasibility. They were most confident of the likelihood that expiring tax cuts would be extended or made permanent early in the new administration, due to the strong consensus among Congressional Republicans and the ease of drafting the legislation. New tax cuts would be more time-consuming and potentially more politically challenging, as they would require complex drafting and analysis, as well as surmount the doubts of deficit hawks. Moreover, they would probably have to be designed and drafted in conjunction with spending cuts, which were expected to produce vigorous debate. Some participants were particularly skeptical of the potential of DOGE to come up with feasible large-scale spending cuts, given its limited lifespan (President-Elect Trump had stated that it would complete its work by July 4, 2026), lack of line authority, and its leadership's lack of government experience and expertise. Nonetheless, while there were differing opinions about the likely magnitude of spending cuts relative to tax cuts, most participants anticipated substantial tax cuts and at least some spending cuts as Republicans had called for in the campaign.

Trump 2.0—Tariffs and Trade Policy

Participants discussed at length the incoming administration's trade policy agenda, including tariff policy, exchange rates, and focus on reducing trade deficits. Opinions were split as to whether it would be possible to eliminate trade deficits through tariff and exchange rate policy while also implementing large-scale tax cuts, but participants agreed that tariffs and trade deficits were central to Trump's vision of economic policy and would therefore be a major focus of the administration.

A number of participants argued that the trade agenda was internally contradictory based on economic theory and empirical studies. They noted that in the aggregate, trade deficits were the

result of spending and investment outstripping production. Thus, unless production rose much faster than consumption and/or investment, the overall trade deficit would not decline, and so the reduction in any particular bilateral deficit would just be reflected in a rise in bilateral deficits elsewhere—as some put it, trying to reduce the overall deficit by reducing all the bilateral deficits was like "Whac-a-Mole." Moreover, they argued that the expansionary fiscal policy of the incoming administration was likely to widen the gap, as demand would grow faster than supply and the tax agenda would incentivize incoming investment (as would the desire by foreign exporters to avoid tariffs by investing in U.S. production). These macroeconomic forces would also tend to lead to dollar appreciation, which would blunt any cost advantages to domestic producers created by imposing tariffs. Efforts to punish trade partners for maintaining weak currencies, which were also advocated by the Trump economic team, would be ineffective in the face of this macro logic.

Other participants were more optimistic about prospects for the Trump trade agenda. They argued U.S. deficits had contributed to deindustrialization at home while building up manufacturing economies abroad, and that this trend needed to be reversed. In some cases, moreover, U.S. manufacturers had been damaged by unfair trade practices, subsidies, and/or currency manipulation in China and other countries, and bilateral tariffs were a necessary measure to even the playing field. They saw the Trump trade policy as establishing the groundwork for a resurgence of U.S.-based production, which over time would allow for more balanced trade.

One big question was how the administration would actually carry out its promised trade policy. Some participants cited reports of plans to impose a 10% across-the-board tariff, with higher levies on particular countries (especially China) and products. Participants noted that this would violate U.S. commitments under various trade agreements, including the USMCA, which had been agreed during the first Trump administration, although few expected that this would deter the administration. At an average level of 10%, participants agreed that tariffs would have little impact on federal government revenues, but also might not distort U.S. trade patterns much due to dollar appreciation. Importantly, many participants were skeptical that tariffs would be levied at a single rate across-the-board. The administration's focus on bilateral trade deficits suggested that higher tariffs would be imposed on exports from economies with higher bilateral surpluses or ones that were seen to be manipulating their currencies.

In trying to predict how the tariff policy would play out, participants debated whether Trump saw tariffs primarily as a way to eliminate the trade deficit, a source of revenue, a bargaining chip, or tactic for reindustrialization. Many participants argued that tariffs were primarily a bargaining chip that could be used to improve the competitive climate for U.S. companies by pressuring foreign countries to restrict exports, increase imports from the U.S., or remove subsidies for domestic companies. Tariffs could also be a bargaining chip to push other policy objectives, such as border controls or stricter enforcement against narcotics trafficking. Thus, these participants anticipated that tariff rates would be lower than promised and much more strategic. Participants also raised the question of how U.S. trade partners would react to the imposition of tariffs. The threat of tariffs could incentivize foreign companies to invest in U.S. manufacturing facilities. It was also argued that, while some countries may calculate that the costs of retaliation exceeded

potential benefits (especially in those cases where dollar appreciation eliminated much of the impact of the tariff), the chance of a trade war with major partners like China or the EU was real.

A question of considerable interest to participants was how the Trump trade policy would affect Japan. Some worried that Japan would be a target, based on past Trump rhetoric as well as the very weak yen. Many were relatively sanguine, however. They noted that, despite strong rhetoric and some trade actions against Japan in Trump's first term, the two countries had actually had mostly positive interactions, including a bilateral trade agreement. Moreover, Japan's bilateral trade surplus with the U.S. had dropped considerably since its peak, leaving it at around one fourth of the U.S.-China gap. Meanwhile, Japanese companies were major investors in the U.S. economy—indeed, Japan had become the largest source of FDI to the U.S. in recent years. That said, some participants worried that this would contribute further to the deindustrialization of Japan and possibly have negative impacts on its economic growth.

Finally, while much of the discussion of the incoming administration's trade policy focused on tariffs and deficits, participants also agreed that it was important to consider the ways in which national security concerns were driving trade and investment policy. They noted in particular the bipartisan consensus on the need to focus on economic security with regard to China. The Trump administration was expected to continue to strengthen restrictions on transfers of intellectual property in critical industries, including via investments into China. More generally, many key players in the incoming administration were in favor of broader decoupling, which could be advanced by higher tariffs, export controls, and investment controls. Some participants raised the concern that the decoupling push was contributing to trade wars or even a new cold war. (Some others countered that the new cold war had already begun.) Chinese retaliation in the form of export controls on critical materials or components could hurt the U.S. economy. More assertive efforts at decoupling could also put Japan and other U.S. partners in the position of having to choose sides, to the detriment of their own economies.

Trump 2.0 —Regulation and Enforcement

Many participants were most excited by the incoming administration's regulatory agenda. They felt that the economy in general and the financial system in particular had been subject to overregulation and overzealous enforcement, increasing costs for investors and entrepreneurs, distorting markets, and retarding innovation and growth. They saw the first Trump administration as having been much more market-friendly and growth-oriented than the Biden administration, and anticipated that the second Trump administration would bring a similar mindset. Some worried, however, about the incoming administration's hostility to international cooperation and the possibility that deregulation in some areas would be detrimental to the economy, environment or society.

Participants noted several factors that would help the administration to reduce the reach of the regulatory state. Perhaps most important was the decision of the Supreme Court to jettison the *Chevron* principle of deference to the judgment of regulatory bodies in interpreting legislation. This decision would strengthen the ability of regulated entities and individuals to push back against regulations and enforcement actions by agencies that were not explicitly mandated by legislation. In financial regulation, a variety of SEC rulemakings had been successfully

challenged in court, and those still pending could be resolved by the SEC no longer defending the challenged regulations. Beyond the rules themselves, regulatory agencies would have considerable discretion over how and when to enforce them. The current leadership of the SEC had been particularly aggressive in enforcing rules and imposing penalties compared to the SEC under previous chairs.

Participants anticipated that the most immediate shift in the approach of regulatory agencies following the appointment of new leadership would be in enforcement, where they could use their discretion to decide where to focus and how to impose discipline. The new administration could well decide not to enforce rules still subject to litigation or rules it intended to significantly revise. Establishing new rules would necessarily take longer, particularly if new legislation were required. Rulemaking must be done in compliance with the requirements of the Administrative Procedure Act, including cost-benefit analysis and public comment, which is time-consuming and subject to judicial review. (Indeed, several of the SEC's recent losses in court were because requirements of the APA had not been properly observed.) Participants noted that the existence of pending court cases over rulemakings offered an important decision point for incoming leaders of regulatory agencies. In cases where new leadership disagreed with the rule in question, they may be tempted to settle enforcement cases. However, that would still leave the new rule in place, requiring an extended period of time to revise the rule due to the requirements of the APA. It was argued that the better strategy would be not to withdraw the cases and instead defend them until a judgment was delivered, in the expectation that the judge would nullify the rule.

The incoming administration was also seen as likely to advance legislation and regulation of crypto assets. Participants welcomed such efforts, as the U.S. was the only major economy that had not yet put in place systematic crypto regulation. Instead, the SEC and CFTC had regulated bits and pieces of the crypto markets, often with ambiguous legal backing, as seen in court cases which the SEC lost. Participants agreed that both the incoming administration and the new Congress (including many Democrats as well as Republicans) were in favor of developing markets in crypto assets, making it more likely that the long legislative logjam would be broken. While drafting and debating legislation would not be a quick process, a number of participants observed that there was a growing consensus on key issues including how to regulate stablecoins and exchanges. Participants expressed hope that a Congress would take a comprehensive approach to crypto regulation that would clarify the responsibilities of particular agencies and ensure the primacy of federal over state regulation, in addition to clarifying how particular assets, institutions, infrastructures, and functions would be defined and regulated..

Finally, there was considerable discussion of the role of DOGE in the regulatory reform agenda of the incoming administration. Opinions about DOGE's benefits and likely effectiveness were mixed. Optimists anticipated that it could lead to substantial efficiency gains both for government operations and for regulated businesses. They noted that DOGE had been created to look deeply and comprehensively across departments and agencies to find inefficient and market-distorting practices, and to reduce the role of the government in the economy. Others were skeptical of the ability of DOGE to identify real inefficiencies rather than just headline-grabbers and of the potential magnitude of cost savings that it would find, given the extent to which entitlements drive the size and growth of government spending. Still, many participants were hopeful that DOGE could help to reduce outdated or overly onerous regulations. Some

expressed a wish that DOGE would recommend a consolidation of financial regulators to make the system more coherent, but few were optimistic. Finally, it was noted that DOGE had no direct authority over budgets, headcounts, or regulations. Even if it were to recommend significant restructuring of staff and programs, most such changes (unless done through attrition and not filling positions) would need to go through the legislative process, which would take time and compromise. Recommended regulatory changes likewise would have to be enacted either through legislation or the APA-mandated rulemaking process, which in turn would be subject to court review. Thus, it was anticipated that DOGE's impact would have to accrue over time.

Trump 2.0—Economic Effects

With a general picture of the incoming administration's policy priorities and likely actions emerging, participants also discussed their likely economic impacts on economic growth, inflation, fiscal deficits, and trade balances.

Many participants anticipated that the combination of deregulation and tax cuts would provide a strong boost to the economy both in the short term and longer term by creating more incentives to invest and increasing households' disposable income. Thus, the incoming administration was expected to stimulate the economy on both the supply and demand sides.

With regard to the federal budget deficit, the expected magnitude of the stimulus depended partly on the extent to which participants expected that tax cuts would be accompanied by spending cuts. While some were confident that the second Trump administration could identify and legislate significant spending cuts to make tax cuts revenue-neutral, others pointed to Trump's promises not to reduce Social Security, Medicare, and defense spending, as well as the record of the first Trump administration, to make the case that spending cuts at the macro level would be much smaller than tax cuts and that indeed spending might actually increase. In contrast, some participants expressed optimism that the positive effects of tax cuts on growth would be more than enough to make up for any gap that would be predicted by standard budget modeling. One note of skepticism to the general expectation of faster growth was raised by some participants who argued that the administration's pledges to curtail illegal immigration and carry out large-scale deportations would restrict growth of supply.

Participants were somewhat divided on the question of inflation as well. Many argued that inflation would be rekindled. They argued that tax cuts would lead to faster growth at a time of full employment, and that this effect would be exacerbated by expected decreases in net immigration. They also pointed to the potential of tariffs to raise prices. Others argued that inflationary effects would be modest at most. Tariffs would likely be offset by a rising dollar and in many product areas, and foreign exporters would absorb some of the cost of tariffs rather than passing them on to consumers. Moreover, the imposition of tariffs would be a one-time price shock even if they did have a large effect. Some also discounted the negative effects of deportations on inflation, partly because their departure from the supply side of the economy would be equaled by their departure from the demand side, and partly because they anticipated that higher investment in labor-saving technologies as a result of the tax cuts would make up for the loss of unskilled labor.

Many participants predicted that current account deficits would rise, at least in the short term. One reason was that demand stimulus would likely take effect before higher investment could expand supply to the same extent. (The tightness of labor markets and the likely reversal of net immigration would limit the potential of short-term supply increases.) In addition, many were skeptical that imposition of tariffs and focus on bilateral trade deficits would change the macroeconomic variables of savings and investment that drive the overall current account deficit. In fact, some argued that tariffs and demand stimulus would lead to higher current account deficits as foreign companies increased their FDI. Higher FDI would also strengthen the dollar, making U.S. exports less competitive on global markets, even though tariffs would cushion cost pressures on import-competing firms. It was noted that trading partners' responses to the imposition of tariffs could affect trade patterns as well.

Japan Lower House Election Effects

Participants also discussed the likely effects of Japan's Lower House election on October 27, which had left Prime Minister Ishiba leading a minority government. Having lost its majority, the existing LDP-Komeito coalition only stayed in power due to the abstention of the Democratic Party for the People (DPP) in the vote for prime minister. But the existing coalition did lose the chairmanship of several Lower House committees and would need to make compromises opposition parties to gain passage of new legislation, including the budget for the fiscal year set to begin on April 1, 2025. The Ishiba administration would also be vulnerable to future no-confidence votes if opposition parties chose to cooperate to take down the government.

The Japanese political situation was thus seen by participants to be uncertain, at least until the Upper House election was held in late July of 2025. While most anticipated that opposition parties would allow Prime Minister Ishiba to stay in place until then, they did not foresee much new legislation in the interim. In contrast, some participants raised the possibility that the threat to LDP-Komeito rule might create incentives for the administration to cooperate with select opposition parties to pursue bold reforms, although others argued that there was little incentive for opposition parties to cooperate with the administration until after assessing the post-Upper House election political landscape.

Even if there were a possibility of reforms in some social or economic programs, many participants did not expect significant changes in macroeconomic or financial policies in the coming months. In terms of financial regulation in particular, participants did not see much distance between the ruling coalition and major opposition parties and predicted that regulation and supervision would not be much affected.

Expectations were somewhat mixed about the effect on fiscal policy. Many participants anticipated looser fiscal policy in the regular budget for the new fiscal year beginning April 1. Some reasoned that opposition parties had specific spending and tax goals that they could pressure the administration to accept whereas no parties wanted to increase taxes or restructure large-scale spending programs like national pensions and health insurance before the Upper House election. Several participants focused particularly on the demand by the DPP to raise the household threshold for income tax; given the coalition's likely reliance on the DPP to remain in power, they expected that some version of that would be passed. While there was a general

consensus that fiscal policy would be somewhat looser, a number of participants argued that the administration's minority status was not the reason for it. Rather, they argued that many members of the LDP-Komeito coalition already had a preference for stimulus, and that the impending Upper House election would make stimulus attractive for all parties regardless. The main issue would be the ways in which fiscal policy would be looser. Many anticipated that there would be a compromise with the DPP that would raise the income tax threshold at least to some extent, as well as some spending increases that would satisfy the main opposition Constitutional Democratic Party (CDP) due to its chairmanship of the Budget Committee.

With regard to U.S.-Japan relations, some suggested that Prime Minister Ishiba may be at a disadvantage in dealing with President Trump. Some worried that Ishiba would not have the same sort of personal chemistry and trusting relationship that former Prime Minister Abe had developed with Trump during his first administration. There was also a concern that its minority status would mean that the Ishiba administration could be a less reliable partner in terms of making agreements that could stick, while also putting it in a weaker bargaining position relative to the U.S. in economically important negotiations including tariffs, currency, and host nation support for U.S. military bases. However, a number of participants pushed back on the notion that Ishiba's personal attributes or political position would significantly color U.S.-Japan relations. They noted that the U.S.-Japan alliance was central to U.S. security policy in the Asia-Pacific. Given the prevalence of China hawks in the Trump administration and its expressed concerns over Chinese economic and military policies, they argued that the U.S. would not be able to push Japan too hard.

For many participants, the most important impact of the political uncertainty would be in the Ishiba administration's ability to respond to external challenges and surprises. Given the multiplicity of economic and geopolitical challenges around the globe, they worried that Japan could easily find itself in a situation where decisive action would be required, but where disagreements between the administration and opposition parties could lead to policy paralysis or even a collapse of the ruling coalition.

Global Effects and Geopolitics

There was considerable debate about what the elections in the U.S. and Japan would mean for the international economy and political order. There were mixed opinions about the foreign policy approaches of the Trump and Ishiba administrations, but many participants noted the extreme policy swings from one U.S. administration to the next over recent years (and arguably back to the early 2000s). They worried that this inconsistency created uncertainty among partners about what to expect from the U.S. On the other hand, some noted that Trump had made unpredictability a feature of his foreign policy, on the basis that it would provide the U.S. with bargaining leverage and make potential foes more wary.

Many participants anticipated that the election results in the U.S. and Japan would contribute to political and economic uncertainty at a time when the international order was already in turmoil on a variety of levels. A number of participants argued that Trump's election would likely reduce the level of military conflict in the world. One reason was his pledge to bring an end to the Ukraine war. Some participants felt that his stated intention to combine non-interventionism with

peace through strength would reduce U.S. involvement in conflict. Others were more skeptical. Some felt that his support for the Israeli government could contribute to more conflict in the Middle East, while others worried that his equivocal statements about the defense of Taiwan could invite Chinese aggression. Others felt that Trump's published remarks reflected the longstanding U.S. approach of strategic ambiguity and that the appointment of China hawks to major foreign policy posts would help to deter any such aggression. Meanwhile, the weakness of the Japanese ruling coalition raised questions about whether Japan would support U.S. actions to deter Chinese aggressive actions in the region or (potentially) defend Taiwan. That could potentially weaken the U.S.-Japan alliance, on which so much of Japan's post-World War Two foreign policy was based.

There was considerable discussion about how Trump's election would affect international economic cooperation. Participants noted that his plan to impose large bilateral tariffs and threat to make extensive use of trade sanctions would upend the assumptions of global, regional, and bilateral trade agreements. While some participants defended the tariff plan as a necessary step to address unfair trade practices or global imbalances, others argued that it threatened global supply chains and would harm economic efficiency, hurting global prosperity and potentially creating economic instability for some countries. These effects would be compounded if the U.S. abrogation of multilateral rules could also embolden other countries to do the same, returning to a world trade system based on reciprocity and unilateralism. Such retaliation could harm the U.S. economy as well as global trade. Some also raised the question of whether Trump's approach to trade, investment, and cross-border payments systems might endanger the role of the dollar, with potentially profound effects on global finance. Finally, as addressed at greater length in Topic 2, the incoming administration's skepticism about global cooperation and global standards could weaken regulatory cooperation through organizations such as the Financial Stability Board (FSB), Basel Committee, and International Organization of Securities Commissions (IOSCO).

Topic 2: Major Issues in Banking and Capital Market Regulation—Basel III Endgame and the Implementation of ESG Rules

In Topic 2, participants addressed major issues in banking and capital market regulation. In banking, the focus was on the implementation of the Basel III Endgame in the U.S. With regard to capital markets regulation, participants discussed ESG and blockchain regulation.

Basel III Endgame

Participants discussed implementation of the Basel III Endgame, the final component of the post-Global Financial Crisis reform cycle for the banking sector, over fifteen years after the onset of the crisis and seven years since its proposal in 2017. They noted that there was considerable international variation in implementation of the Endgame. While it had been fully implemented in Japan and some other economies, the U.S., EU, and UK had not yet done so. Moreover, all three had introduced modifications in order to better fit the particulars of their domestic banking systems. While some characterized the Endgame as an incremental change or as the "cherry on top of the sundae," banks in the U.S. and Europe had resisted several key elements that would have raised costs for them. This was seen as a particular concern for Japanese regulators and banks, which saw the U.S. and European behavior as an attempt to create competitive advantage at the expense of global financial stability.

It was argued that the modifications already decided in the EU and UK violated the spirit of the global agreement, focusing instead on blunting the negative effects on banks' profitability and ability to lend. In the U.S., there had been a spirited contest over what the Endgame should entail. The initial proposal from the Fed, which gold-plated Basel III with even higher capital requirements, had been widely criticized by banks for raising capital requirements far beyond the standards seen in other economies and impairing banks' ability to lend. After public comment and further development, risk-weighted capital requirements were reportedly dialed back somewhat in the revised standards under discussion in September 2024, although they apparently still required greater regulatory capital, especially for the largest banks.

The election of Donald Trump created new uncertainty about any implementation of the Endgame in the U.S., given general skepticism of new regulation and concern how the proposal would affect economic growth. An important question was the status of the Biden-era vice-chair for supervision, Michael Barr, who had proposed the new U.S. rule. Would he step down before his term ended in July 2026, or could he be forced out of the position if he did not? At the time of the Symposium, both questions were undecided.

It was also argued that the Trump administration would not feel bound to accept global standards at all, unless U.S. regulatory agencies or Congress decided they were appropriate and cost-effective. A number of participants argued that this was therefore an opportunity to rethink the correct level and calculation of risk-weighted capital, as they felt that the Endgame proposal was

too restrictive. One particular target for criticism was the output floor, which favored a more standardized approach rather than reliance on bank models. Other participants argued that it was important to honor global commitments and to improve international regulatory consistency. They worried that further modifications to the Endgame would gut the implementation of Basel III in the U.S., and that the EU and UK might further weaken their own standards, leaving Japan's globally active banks as the only major banks to be fully subject to the supposedly "global" standards.

Does Basel III Promote Financial Stability?

Some participants argued that the election of Trump raised the possibility of a full-scale rethink of how to regulate major banks. They raised several criticisms. First, they argued that capital was a costly way to improve solvency, and that at current levels of regulatory capital, each incremental increase had little actual effect on solvency in the event of a problem. Second, some were critical of the mechanistic nature of calculating capital and liquidity buffers under Basel III, arguing that the Basel II principle of deference to banks' own internal risk models was better than reliance on a standardized approach. Third, they argued that regulatory capital, liquidity buffers, and resolution plans were often ineffective in actual banking crises, as shown in the failure of Silicon Valley Bank in 2023. In that case, SVB was not actually insolvent at the time of the deposit run based on applicable accounting standards (valuing hold-to-maturity government bonds at par). Had the Fed acted immediately as lender of last resort, the run could have been stopped in its tracks, with no further reverberations through the banking system, even though the market value of the bank's Treasury bonds had declined due to rising interest rates. This point was underscored by the decision of the Fed to value these assets at par under the Bank Term Funding Program established after SVB was put into FDIC insolvency. With regard to liquidity buffers, they argued that banks would run through regulatory liquidity very quickly in a crisis, so that they did not really diminish the necessity of the Fed to lend in the event of a run. Thus, the key to effective crisis management would be setting up systems to allow rapid borrowing from the central bank, such as pre-agreement on collateral. While acknowledging the importance of the central bank in providing emergency liquidity, some participants worried about the danger of moral hazard if banks could be assured of access to liquidity in spite of mismanagement. They argued that costly regulations like capital charges and liquidity buffers could be helpful in preventing risky behavior, even if they reduced profitability.

A number of participants also raised concerns about applying different capital requirements to different sized banks due to U.S. legislation as implemented by the Fed in the first Trump administration. In the U.S., SVB was seen as a classic example of a bank that had been subject to less stringent supervision and capital requirements. This raised two questions. The first was whether the thresholds were appropriate and how banks approaching the systemically important bank threshold should be regulated. One possibility would be to lower the thresholds. However, participants questioned whether the financial stability benefits would exceed the costs to banks and their ability to extend loans. A second quite different question was whether the current thresholds were a disincentive to M&A and consolidation of the banking system. A number of participants argued that the U.S. banking system remained much too fragmented and would benefit from a round of consolidation, in order to promote efficiency and improve functions like

cybersecurity and risk management.. Thus, Basel III rules were weakening the competitiveness and efficiency of the U.S. banking system.

In Japan as well, regional banks were subject to different capital rules than large commercial banks. While a number of participants praised the quality of supervision of both large and small banks in Japan, some cautioned that some Japanese regional banks had been allowed to seek yield by investing in risky assets that they did not necessarily understand, such as international securities and private equity products. Others countered that even if these regional banks found themselves in trouble as a result, contagion was unlikely and the deposit insurance system could manage them without endangering financial stability.

The other issue was the regulatory perimeter that resulted in the migration of risk out of the banking system. A number of participants noted that the rapid rise of private equity and private credit in the U.S. (and to a lesser extent, Europe and Japan) had been driven by the rising costs of doing business as a bank. Bank lending was a decreasing proportion not only of overall financing, but also of lending. This raised the question of whether Basel III would actually reduce risk in the financial system, or simply further displace it to NBFIs where it would be difficult to monitor. Some participants worried that private markets had become a regulatory black hole that could be the source of the next financial crisis. Thus, the regulatory perimeter should be extended to NBFIs, including some sort of capital and resolution planning requirements in addition to enhanced disclosure. Others countered that financial stability risks depended on the extent and type of interconnections with traditional financial institutions like banks and insurance companies. They noted that banks were regulated differently from other corporations because of their centrality to the payment system as well as the inherent dangers of maturity transformation, which left them vulnerable to runs on deposits. The basic business model of private equity and credit, in contrast, relied on maturity matching. Closed-end funds were not vulnerable to run risk, even if their assets depreciated, and therefore should not be regulated on a banking model. However, others argued that the reliance on leverage of private funds could endanger banks or insurers. Others countered that this could be controlled by better supervision of lender providers. While this was functionally the way that private market risks to financial stability were being managed by supervisors in the U.S. and Japan, a number of participants argued that it was unfair to have banks and insurers shoulder the costs of compliance for unregulated entities.

ESG and Regulation

Turning to capital markets, there was considerable discussion of how environmental, social, and governance issues should be addressed by market regulators. The rise of investor interest in ESG financial products in recent years had raised concerns about inconsistent standards and the possibility of greenwashing. More fundamentally, regulators saw climate disclosure requirements as a means to reduce carbon emissions. Indeed, some jurisdictions, particularly the EU, had incorporated ESG principles into regulation of financial institutions, government programs, and even central banking. Thus, how to regulate ESG concerns had become an important question for financial regulatory authorities.

A number of participants spoke approvingly of the ways in which ESG finance had developed in Japan. Participants noted that the importance of ESG issues was widely accepted among investors, firms, regulators, and policymakers. However, unlike in the EU there was as yet no political mandate to regulate emissions through financial regulation, so the focus of regulators was on the importance of disclosure to investors and companies. Already, Japanese authorities including the Tokyo Stock Exchange and FSA required disclosures following the guidelines of the Task Force on Climate-Related Financial Disclosures (TCFD), and preparation for future disclosure rules was being carried out by the Sustainability Standards Board of Japan under the auspices of the Financial Accounting Standards Foundation. Thus, Japan was developing and implementing ESG reporting standards in a methodical and consultative way. It was argued that one reason that this was possible was the high degree of consensus about the relevance of ESG to investors and companies. One impetus for developing clear standards was earlier concerns among investors about whether ESG funds were actually "green." Moreover, many Japanese companies were enthusiastic about implementing ESG principles through their own operations and those of their suppliers, and customers were eager to see adherence to those principles as well. As a result, participants agreed that there was strong compliance on ESG disclosure by corporations. Meanwhile, regulators adopted a relatively light touch, relying on guidance rather than enforcement to improve the quality of disclosures. At least to date, penalties were only imposed on false or fraudulent disclosures, as the goal of regulators was to gradually improve their usefulness as standards continued to evolve.

A number of participants contrasted this with the situation in the U.S. In the absence of legislation or adoption of a uniform set of standards, participants argued that the SEC had taken it upon itself to create rules and enforce them vigorously, not only to protect investors but also to reduce carbon emissions. They observed that these rules were being challenged in the courts. A number of participants argued that SEC rulemaking had been flawed, as it was based on unrealistic cost-benefit calculations. In fact, they argued, the costs of compliance were considerably higher than in the SEC model, while actual benefits to investors were much lower. Given the lack of Congressional mandate to use the financial system to drive progress toward national environmental and climate goals (as existed in the EU), they felt that calculation of potential benefits should be limited to the effects on investors rather than assessing environmental damage more generally. Further, many participants noted, existing rules already mandated disclosure of materially relevant information. In other words, they felt that the imposition of additional ESG reporting added no material information, but did add considerable costs of compliance. Also, unlike the Japanese FSA, which emphasized consultation and guidance to improve corporate ESG disclosure, the SEC had been generally aggressive in many other areas in litigating and punishing companies whose disclosure did not meet its standards.

Participants discussed how ESG reporting should be handled in the U.S. A number of participants argued that the materiality standard was sufficient for assuring the integrity of financial markets and that separate ESG disclosures were not necessary to protect investors. In addition, many thought the SEC should establish a safe harbor from private litigation under these standards (as it had under its initial proposal for Scope 3) given the difficulty in the metrics that would underlie increased disclosure. Some participants also worried that the compliance costs would drive companies away from public markets. On the other hand, some argued that the challenge of climate change was so great that the disclosure requirements should be extended to

private markets., They further contended that mandating reporting on the basis of a widely accepted set of standards like TCFD or ISSB would put the U.S. in line with international practices.

Looking forward to the Trump administration, most participants anticipated that the new SEC leadership would likely leave disclosure and investment decisions to the market. As for current ESG disclosure rules, many expected that the courts would nullify them. If not, participants expected that the SEC would respond first by redirecting enforcement efforts away from ESG reporting. Outside of enforcement, some suggested that the federal government might follow the example of some state governments by disallowing ESG options for employee retirement funds.

Blockchain and Crypto Regulation

Finally, participants discussed the likely path of regulation of crypto assets like Bitcoin and blockchain technology. The incoming Trump administration had made clear that it would be crypto friendly and open to a variety of technological innovations in financial markets. However, it was not clear how incoming regulators and legislators would balance the opportunities and risks inherent raised by crypto and blockchain.

With regard to crypto, participants saw two main concerns for regulators: how to handle potential financial stability risks and criminal behavior. With regard to financial stability concerns, much of the focus was on stablecoin regulation. Many participants predicted that stablecoins would increasingly be used for a variety of payments, rather than just mediating between the traditional financial system and crypto assets. Moreover, some savers might choose to keep their money in stablecoins on an ongoing basis, particularly if they were to begin paying interest, rather than just using them as a way of moving between traditional finance and crypto. In other words, they argued that stablecoins would increasingly be carrying out key functions of banks, making them an essential financial infrastructure. This would require regulation both to ensure the integrity of customer funds (such as currency backing, disclosure, and protection from cyber theft) as well as to prevent the use of stablecoins for illegal purposes (such as money laundering, criminal and terrorist financing, and tax evasion). On the other hand, there was considerable skepticism about the actual prospect of offering interest, thus somewhat undercutting the call for more expansive regulation.

Crypto assets were also discussed. While some participants expressed concern about the riskiness of crypto assets, others argued that retail investors were already able to invest in highly risky assets like meme stocks and derivatives through app-based trading platforms. Thus, rather than mandating what assets investors could put their money into, these participants argued that the most important thing was to address classic issues of market integrity, like financial reporting, custody, front-running, and insider trading.

Beyond regulation, some participants emphasized the importance of adapting macroprudential supervision to a new world of tokenization. While potentially increasing efficiency and reducing costs to all sorts of financial transactions, these participants saw tokenization as also carrying dangers for financial stability. One reason was the sheer speed with which transactions could be carried out and settled, which could allow for runs on financial institutions, securities, and even currencies. Central bank monitoring of flow of funds would also be harder to maintain. In

addition, transactions could be harder to reverse in the case of fraud or theft. Central banks and macroprudential supervisors would thus need new tools to maintain financial stability.

Outside of crypto assets, a number of participants saw blockchain technology as a potentially revolutionary financial technology. Already, it was transforming supply chain management in many areas, allowing enhanced tracking and verification of components, cold-chains, etc. In finance, the potential for smart contracts and instant settlement could increase efficiency of transactions, potentially creating a boon for investors. However, here too, regulators would need to ramp up their capabilities to prevent misuse or unforeseen consequences.

Topic 3: How Likely Is a Soft Landing in the U.S. and Japan?

In Topic 3, participants discussed macroeconomic prospects for Japan and the U.S. Many saw benign environments in both countries for both growth and inflation. However, some worried that the recovery in Japan might be fragile, that stimulative policies in the U.S. would have inflationary consequences, or that new international crises might hurt growth or reignite inflation in both countries.

Prospects for Soft Landing in the U.S.

Participants were generally optimistic about macroeconomic conditions in the U.S., especially the prospects for economic growth. Indeed, some claimed that that a soft landing had already been achieved and that growth was poised to accelerate again under the incoming administration. Inflation had largely normalized without a recession, and it was argued that companies were losing pricing power in the post-COVID period and households were increasingly price sensitive. Meanwhile, household income was rising due to higher wages, increasing real disposable income. Companies were responding to higher wages with more investment, which in turn contributed to productivity and contained inflationary pressures. Thus, optimists foresaw a virtuous cycle.

Others argued that inflation was not yet under control. Furthermore, the anticipated Trump tax cuts would stimulate demand faster than supply. While this would be positive for economic growth, it would also add to inflationary pressures. Although these participants did not predict a spike in inflation like in 2021-22, they anticipated that it might approach 3% rather than returning to the 2% target. Thus, the Fed would be wary of lowering rates for the time being.

However, participants also saw some potential risks to the continuation of positive economic conditions. One particular concern was the rising fiscal debt. As noted in Topic 1, many participants anticipated rising deficits under the new administration. With federal debt exceeding 120% of GDP, debt sustainability issues could come into play, dampening confidence in the economy or leading to higher long-term interest rates. Aging society and the rapid expansion of retirees would add further stress to the deficit and debt on both expenditure side (Social Security and Medicare) and revenue side (due to declining share of working age population). Natural disasters or international conflict could also threaten growth and inflation.

It was argued that some Trump policies could also slow growth and accelerate inflation, although it was not clear to what extent. Deportations and restrictions on immigration could cause significant shortages, and therefore price rises, in particular sectors, including agriculture, food preparation and processing, and construction. The actual impact would depend a lot on the extent to which the incoming administration reduced net immigration. Also, some predicted some specific carve-outs, such as in agriculture. Tariffs would also affect prices, although it was not clear whether price rises would be one-off price shifts or would have knock-on effects. Inflationary effects would also depend on the magnitude and distribution of tariffs, as well as

how exchange rates would adjust. If new trade restrictions were to set off a trade war, however, effects on growth and prices could be large. Some also worried that President-Elect Trump would follow through on threats to increase political control of the Fed, which could lead to easy money and higher inflation.

Prospects for Soft Landing in Japan

Many participants were also optimistic about a soft landing in Japan. After a quarter century of ultra-low inflation and deflation, they argued that inflation had normalized, allowing the BOJ to normalize monetary policy as well.

It was argued that Japan had reentered a virtuous cycle. Thanks partly to imported inflation during the COVID period, inflationary expectations had finally risen from 0% to 2%, converging with actual inflation. Higher inflationary expectations also reflected the success of the BOJ strategy of intentional overshooting on inflation in the last three years. Real wages had also grown for the second straight year, with nominal wage growth over around 3%, reflecting both robust economic growth and labor market conditions. Labor conditions in Japan were seen as very tight—on some measures even approaching the supply and demand conditions of the peak of the bubble. This reflected both cyclical recovery and structural factors (aging society).

Wage growth would fuel household spending, while also incentivizing businesses to increase capital investment instead of simply sitting on retained earnings. Despite the slow shrinking of the working age population, employment also remained robust as more women and seniors held jobs and overall labor hours increased in response to higher demand.

Other participants were more cautious. Some pointed to measures suggesting inflationary expectations closer to 1.5% than 2% as well as weaker estimates of 2024 GDP growth. Also, it was noted that the IMF was predicting fiscal contraction in 2025, which could also dampen growth; however, most participants were anticipating the opposite, due to the weak position of the Ishiba's minority government as well as preferences across the political spectrum for more government spending.

In response, the BOJ was normalizing monetary policy. It discontinued its policy of Qualitative and Quantitative Easting with Yield Curve Control in March 2024 and in July ended the zero short-term interest rate policy and began to reduce the size of its balance sheet. At the time of the Symposium, the 10-year JGB rate was comfortably above 1%. While the BOJ had taken a pause in raising short-term rates, the era of zero interest rates appeared to be over. Interestingly, few participants predicted that the BOJ would raise rates more quickly in order to support the yen, despite its weakness. Since the Ministry of Finance rather than the BOJ was responsible for the external value of the yen, the BOJ monitored it primarily as an indicator of potential price pass-through since a weak yen could affect overall inflation by raising the yen prices of imports.

Still, several concerns remained. Long-term factors included the aging society and Japan's extremely high fiscal debt, albeit largely held domestically. Given Japan's ongoing reliance on loose fiscal policy to make up for low private demand, it would be difficult to eliminate deficits. Meanwhile, debt service would rise along with higher interest rates. In the nearer term, major concerns included the potential impact of U.S. tariffs, vulnerability to changing conditions in

global energy markets, and the ever-present possibility of international conflict, pandemic, or natural disasters disrupting supply chains again.

Finally, there were some dissenting views as well. They predicted that U.S. tariffs would hurt Japanese exporters both directly and through their intermediate product exports to countries like China and Korea (if U.S. tariffs led to an overall decrease in their production of goods that incorporated Japanese intermediate goods). Moreover, Trump policies were likely to strengthen the dollar and weaken the yen, hurting real household consumption. They argued that real consumer spending in Japan had been stagnant since 2013, at least partly due to imported inflation. If demand growth faltered, wage hikes may also not be sustainable as optimists expected.

Topic 4: Will "AI" Transform Financial Markets?

In Topic 4, participants discussed the role of artificial intelligence in financial markets, regulation, and supervision. They noted that the blanket term "AI" comprised a variety of underlying phenomena, each with quite different characteristics. Moreover, versions of AI had already penetrated deeply into some parts of financial services, while financial institutions and regulators remained wary about other uses.

Uses of AI in Financial Markets

Participants discussed the past, present, and future uses of AI in financial markets, as well as the use-cases for various types of AI. They agreed that the use of AI in finance should be understood as an evolution rather than a revolution. Algorithmic programming and machine learning (ML) were already well-established for a variety of uses, whereas the use of large language models (LLMs) and especially generative AI was at a more preliminary stage.

AI had already transformed some parts of the financial system. Algorithmic trading had been an essential feature of financial markets for decades, and over time it had been enhanced by further application of machine learning. AI was presently not only used by traders for spotting market trends and anomalies, it was also used by both traders and trading platforms to optimize order flow. These methods had enabled drastic reductions in the cost and efficiency of trading, as well as enhancing liquidity in a variety of platforms and exchanges.

Similarly, financial institutions had vastly improved the accuracy and cost-efficiency of their anti-money laundering and fraud prevention systems thanks to ML techniques. ML was particularly well-suited to this task because of its ability to identify patterns and anomalies in data.

More recently, natural language chatbots had increasingly been used to increase efficiency in customer service. By automating responses to standard inquiries and streamlining information retrieval, chatbots and virtual assistants could improve the speed and accuracy of responding to customer inquiries. It was noted, however, that this was still a work in progress. Many customers preferred dealing with human representatives; also, chatbot-based customer service was best at dealing with general and/or common questions rather than providing tailored advice. Many participants foresaw much greater use of AI (particularly generative AI) in financial planning going forward, but concerns over accuracy, "hallucinations," and liability for misguided advice needed to be addressed before it could be deployed at scale.

ML and natural language programming had become indispensable tools for researchers and financial analysts, due to their ability to review and summarize vast amounts of structured and unstructured data. For quantitative research, machine learning techniques could quickly identify and compare relevant data, as well as automate presentation of data in useful graphs and tables. Some financial institutions and analysts were also deploying generative AI to generate new queries and metrics. For example, some participants argued that review of unstructured data

could improve the accuracy and efficiency of credit ratings, particularly for new borrowers or in economies where credit information was incomplete or unreliable.

One of the most pervasive uses of generative AI was in assisted coding. This had revolutionized the ability of financial institutions to design and price new products, for platforms and exchanges to improve efficiency of trading and settlement, and for start-ups and fintechs to provide services at scale. While assisted coding did not eliminate the need for software engineers to design and oversee new products and services, it made them much more productive and allowed them to test multiple approaches to find the best and most efficient ones.

Challenges of AI for Financial Institutions and Regulators

Despite the promises of AI for transforming financial markets, new technologies also raised some serious concerns. In particular, these included hallucinations, lack of explainability, possible herd behavior, concentration, and legal liability.

A particular concern for participants was the potential for generative AI of producing incorrect or misleading results, known as "hallucinations." Generative AI's ability to produce natural language prose via prediction, while highly capable of creating clear and grammatically correct text, was also capable of producing inaccurate but plausible-sounding "facts" since it lacked an understanding of the underlying theory and logic needed for analysis. In addition, depending on the training data, LLMs could easily reproduce biases or cognitive errors, leading to inaccurate and discriminatory outputs that could create legal liability for users. This raised the importance of selecting appropriate training data. LLMs were also bad at logical and mathematical reasoning, so it was necessary to use alternative methods for such analysis.

Another major issue was explainability. Neural networks in ML and LLMs created their own decision-making systems based on observed associations in data rather than being built on clear formulas that could be analyzed and justified to decision makers and regulators. As of yet, models were not able to consistently and accurately explain how or why they made decisions, although participants noted that efforts were underway to improve explainability. From a regulatory point of view, the lack of explainability of AI outputs posed a serious problem. Regulators needed to understand decision-making mechanisms before approving their use in sensitive functions, so as to prevent the possibility of system failures, runs, or even illegal activities. Similarly, established financial institutions such as banks, which relied on maintaining customers' trust, would be wary of introducing services that could go awry or violate regulations. For example, one reason why the use of virtual assistants in financial planning remained limited was that even a small number of cases of misadvising customers could both drive away other customers and create considerable liability. Regulators too were wary of relying on AI for financial planning due to their responsibilities for customer protection.

A third concern was concentration. While in AI was in some ways an open field with many start-ups and new entrants, certain aspects displayed high levels of concentration. This was particularly true for LLMs and generative AI, which required enormous amounts of data and processing power for training and to digest new data. A small number of firms such as Google and Amazon Web Services dominated this segment of the industry, and new entry was restricted not only by the costs of physical investment but also by the advantages to early entrants who had

already amassed enormous stores of data. In other words, this was seen as a classic increasing-return-to-scale industry, creating both hazards of unfair competition and concentration of risk.

Finally, a number of participants raised the question of diminishing returns to scale. There were indications that for some functions, the cost of new investment would soon exceed the benefits. This suggested the need to develop new AI models that could operate more efficiently and that could address some of the weaknesses of existing models. Also, participants agreed that convergence to a general model was not the most effective way to address the needs of financial markets and institutions. As one participant put it, the current trajectory was toward a "diverse zoo" of models and uses.

In order to address these concerns, participants agreed that it was still important to maintain human decision making, particularly for critical functions. In this vision, AI was just one more tool rather than a general automaton, and required oversight. While some of the concerns over AI, such as explainability, could potentially be addressed by improving on existing models or creating new ones, financial institutions would need to take responsibility for their actions regardless of whether they were human- or AI-generated. Regulators too would likely continue to require human oversight as well as caution in making use of AI in critical functions.

Nonetheless, participants agreed that it was important not to stifle innovation in the AI space. While financial stability and compliance concerns must be addressed, and caution would need to be exercised in introducing new techniques and models into critical functions, both U.S. and Japanese financial institutions and regulators were committed to making use of AI to improve efficiency, profitability, and customer service.

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