

JAPAN CHAIR PLATFORM

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The Privatization of Japan Post Is Unstoppable

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The forces behind the public works spending that eroded the Japanese economy in the twentieth century have resurfaced recently, but the symbol of structural reform initiated by former prime minister Junichiro Koizumi stands on solid ground. On October 1, 2007, the privatization process for Japan's postal service passed the second and most important milestone in a long-term plan designed to promote greater competition in the Japanese economy. Japan Post, which had been changed from a government agency to a state-controlled corporation back in 2003, was reorganized into four different business units—banking, insurance, mail service, and over-the-counter services—under Japan Post Holdings Co., Ltd., a holding company that will manage those units with indirect government control until complete privatization in 2017. Changing Japan Post's 136-year-old culture requires patience and a commitment to overcoming both structural and political challenges. There will no doubt be a few bumps in the road, but the potential economic advantages make this process worthwhile. Ultimately, the privatization of Japan Post will not be blocked by domestic politics.

A Daunting Task

Postal privatization would bring positive economic effects by eliminating traditional pump priming in the form of fiscal investment and loan programs (FILPs)—essentially an “automatic money supply”—thereby reducing pressure on the government budget. The FILPs, using money provided by Japan Post, were controlled by the government and politicians who were backed by local interests involved with road construction and other public works, which was criticized for years as a waste of money and a buildup of hidden losses that would ultimately be covered by tax revenue. This is the most important reason why the Koizumi administration decided to privatize Japan Post, and no politician will argue in favor of FILPs directly because all Japanese voters fully understand the importance of reform. However, FILPs were successful in supporting small businesses and individuals in rural areas, so Japan Post is in a difficult position. Politicians against reform want to use it as a tool for political maneuvering by blaming postal privatization for an increasing income and wealth gap between rural and urban areas, and the antireform camp has not surrendered its hope to reinstate the high-cost structure of Japanese postal services, even though that is most unlikely. Meanwhile, commercial banks and corporations that are now competitors of Japan Post want to protect their profits by limiting its operations and preventing the emergence of this giant player into the market, which may in turn encourage them to shake hands with antireform politicians to slow down or change the direction of postal privatization.

Potential Impact

Japan Post is now the biggest corporation in Japan in terms of the number of people it employs, 240,000. Japan Post Bank is the biggest commercial bank in the world with total assets of 231 trillion yen, or \$2.158 trillion, as of March 31, 2007. Japan Post Insurance, the so-called *Kampo*, is the biggest life insurance company in the world with total assets of 116 trillion yen, or \$1.084 trillion, as of March 31, 2007. Each is about two times bigger than the second largest competitors, and they operate through 24,000 branches in the Japan Post network, which is larger than that of any other service company in Japan and more than twice that of all Japanese banks' branches.

The advantage of Japan Post in terms of employees, assets, and networks is viewed as a threat from competitors. Regional banks are especially nervous because the deposit share of Japan Post Bank in every prefecture except

Tokyo, Osaka, and Okinawa is more than 20 percent and outnumbers any other bank. Japan Post Bank is also increasingly competitive in the sale of mutual funds. The Japanese Bankers Association and Regional Banks Association have repeatedly accused Japan Post of having an unfair advantage, but since last October some banks and corporations have begun to work together with Japan Post in order to survive. For example, Suruga Bank, one of the big regional banks, began discussions of an alliance last October focusing on residential mortgage loans. Also, Japan Post will integrate parcel delivery services with Nippon Express this October to battle against the strongest competitor, Yamato Transport.

Challenges

Japan Post's old-fashioned and ingrained management structure, which is based on cozy relationships between Japan Post and related businesses, presents a major challenge in the privatization process. In what is known as the hereditary system, local Japan Post branch managers have benefited from guaranteed employment by taking over such responsibilities from their parents and grandparents and maintaining long-established client relationships over generations. Privatization would dictate that this arrangement be broken but that cannot happen overnight. Japan Post's chief executive officer, Yoshifumi Nishikawa (former CEO of Sumitomo Mitsui Financial Group), is working hard to end corruption stemming from these closed networks. For example, Japan Post has leased many branch offices from its affiliates that manage retirement benefit funds for its employees. The rent yield is about 10 percent per annum, which is almost two times that of other office lease transactions in Japan. Rent from Japan Post has boosted the profits of those affiliates and, therefore, the retirement funds of Japan Post employees.

The privatization process will be painful in rural and depopulated areas where operations were not profitable. Politicians opposed to reform, especially in the People's New Party and the Democratic Party of Japan, discussed a bill to abolish the postal privatization plan after the ruling Liberal Democratic Party was defeated in the Upper House election last July. However, they ended up amending the existing bill to prohibit the sale of Japan Post Bank and Japan Post Insurance shares to the public. This was to protect these two affiliate companies from takeovers by foreign financial institutions or American private equity funds. Most Japanese politicians understood the limitations of a policy against the privatization process. Voters don't want to stop it because it is the only economic reform in place and they are angry about the fact that the Social Insurance Agency disclosed last year that it had lost 50 million public pension account records, an issue that has plagued many politicians over the last year.

Steady Progress

There is a concern that the current political turmoil in Japan, where a divided legislature could cause policy paralysis, will have a negative impact on the postal privatization process. Prime Minister Fukuda has not offered specifics on economic reform, but it is quite clear that he pays close attention to public opinion. Postal privatization was controversial in the Diet last year and caused political and social rifts until last summer. However, it was not a major theme in the Upper House election, and there is no noticeable discussion against privatization now. The new Japan Post Holdings Co., Ltd., began operations last October with middling performance, including operational alliances with some other companies. The privatization of Japan Post will therefore continue steadily regardless of the situation in Japanese politics.

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