Steep Road Ahead for Postal Privatization

By Tani Sadafumi

IN late-April, the government's Council on Economic and Fiscal Policy (CEFP) compiled an interim report on the privatization of Japan's postal system. In addition to proposing a schedule for the phased privatization of the postal service, postal savings and postal life insurance, the report envisages at the same time the abolition of government guarantees for postal savings and insurance, and the creation of a level competitive playing field with the private sector. With a House of Councilors election approaching in July, however, all politically unpopular issues have been deferred until a final report scheduled to be drafted in the autumn. Inevitably, the result will be a heated debate beginning this summer.

Postal service reform is a policy topic whose most ardent proponent has been Prime Minister Koizumi Junichiro. The interim report consists of three main sections: the significance of privatization, the process of privatization and directions for the reform of the four postal service functions, which refers to the post office network, postal service, postal savings and life insurance.

The significance of privatization lies in reducing the flow of funds to the public sector. It signifies an attempt to reform the Fiscal Investment and Loan Program, under which the funds absorbed by the postal savings and insurance systems flow to the operations of government-affiliated special corporations. The program has been criticized for using repayable postal savings for policy objectives like tax revenue, and for serving merely to perpetuate the franchises of politicians and bureaucrats, while accumulating more latent delinquent assets.

The privatization process is envisaged to follow a three-stage schedule beginning with its initiation in 2007, followed by a transition period of 5–10 years and concluding with a completion period. Maintaining employee ethics and labor relations is an additional requirement.

The most controversial item on the reform agenda concerns the abovementioned "four functions." Formulated policy calls for a positioning of the post office network as a provider of a wide range of services through its network points, to be maintained for the benefit of the public. Resistance to privatization is fueled by concern about possible closures of post offices in depopulated areas, or unprofitable branches in urban locations. If privatization is to happen, the consolidation of selected post offices will be unavoidable unless new income opportunities can be found. The interim report, however, stops at hinting at a concern for universal services.

The same holds true for the three remaining operations. For postal service, while the interim report acknowledges that a maximum of efficiency is required, it provides only abstract direction of "strategic advances into domestic and foreign growth markets." Concerning postal savings and insurance, the introduction of corporation tax, compulsory payment of deposit insurance premiums and discontinuation of government guarantees have been proposed as basic rules without, however, mentioning their final shape. By contrast, the objective of contributing to the smooth absorption of Japanese government bonds (JGBs) has been included. This was done to satisfy the concerns of the Ministry of Finance (MOF) that the smooth market clearance for JGBs might come under threat, given that Japan Post holds 23% of the issued and outstanding JGBs worth ¥126 trillion in its portfolio.

Coinciding with the government's interim report, April 26 marked the inauguration of the Preparatory Office for the Privatization of Postal Services (POPPS). Its principal tasks include preparation of the final draft report to be compiled by the CEFP this autumn, as well as privatization-related draft legislation to be submitted to the 2005 ordinary parliamentary session. The POPPS include approximately 20 members dispatched from the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT), MOF, the Cabinet Office and other related agencies. Including private sector members from the finance and distribution industries, the headcount will have reached 50 by the summer.

The issue of postal system reform is associated with a long history of strife between the former Ministry of Posts and Telecommunications (now the MPHPT) and the MOF. It is for this reason that the post of head of the POPPS went to Watanabe Yoshiaki, a former Vice-Minister of Agriculture, Forestry and Fisheries in a bid to give the office a neutral status. Nabekura Shinichi, a former Vice-Minister for Policy Coordination with the MPHPT, and Takagi Shokichi, the Financial Services Agency (FSA, formerly the MOF) Commissioner, became deputy heads in order to preserve a balance. The three members represent a substantial staff line-up of vice-minister caliber.

Opposing arguments and issues that need to be resolved can roughly be divided into the three areas of: 1) competition with the private sector; 2) maintenance of the postal network; and 3) the linkage to public finances.

The first issue comprises two directly opposing views: one fearing competitive pressure on the private sector, the other addressing concern over the system's viability after privatization. Beginning with the first issue, ¥230 trillion in postal deposit accounts equals the aggregate total of the four mega-banks' deposits, while at ¥125 trillion, the total assets of the postal insurance system are approximately three times the size of those of Nippon Life Insurance Co. Combined postal savings and insurance assets amount to 60% of the aggregate total of private-sector financial institutions and insurance companies.

Banking and insurance industries have been sounding warnings concerning the scope of operations during the transition period of privatization. In a related comment, the chairman of the Japanese Bankers Association, Nishikawa Yoshifumi, who also acts as president and CEO of Sumitomo Mitsui Banking Corp., was hoping for curbs on the scope of operations during the transition period. The concern is that, amid unequal competitive conditions with the private sector in regard to corporation tax, deposit insurance premiums and government guarantees, increasing management freedom might lead to the launch of attractive products that private sector businesses cannot offer due to cost reasons.

Fear also reigns supreme among regional financial institutions. Especially, Shinkin Banks (credit unions) and credit co-operatives would be faced with direct competition from the line-up of financial products at post offices. By contrast, a convenience-store concept using the post office network, which is also being considered, has failed to raise concern in the convenience store industry, which dismisses the idea of their entry into the food-handling business as hopeless, considering their absence of know-how: "At the most, they would be able to sell a range of sundry items."

And then there are those voices that express concern over the future of post office operations after privatization. Up until now, postal savings balances have been able to grow on the strength of an attractive product consisting of a fixed-amount 10-year time deposit permitting unrestricted withdrawals after an initial six-month period. However, with government guarantees to be abolished, and with an estimated ¥200 billion annually to be paid in deposit insurance premiums in addition to corporation taxes, many believe that it will be difficult to offer this type of product.

As an executive at the Bank of Japan points out, "Japan Post owns no special know-how whatsoever, be it in fund procurement and management, asset liability management, or logistics." Moreover, the executive observes that "a CEO should be scouted from the private sector. If no one wants the job, it is undoubtedly over the manageability of the organization, and structures must be redesigned without hesitation in order to make the business viable," a warning not to leave organizational structures untouched and let it end in some half-baked privatization attempt.

Another big problem concerns the question of which government agency will supervise the postal savings and life insurance operations after privatization. Placing supervision in the hands of the MPHPT, as in the case of Japan Post, would result in dual-track policy operations parallel to those of the FSA's supervision of the banking and insurance industries. Since banking and insurance laws will be applicable if postal operations become private sector institutions, it would be logical for the FSA to exercise sole supervision, but it is difficult to envisage the MPHPT relinquishing the authority.

The post office network is a political issue. Japan has 24,700 postal service network points, and 19,000 of these are special post offices. These post offices date back to the inception of Japan's postal service during the Meiji period (1868-1912), fashioned after the British model, in the course of which prominent locals were appointed to set up post offices in their houses, as it was impracticable for the government to create a post office network by itself. This made it possible to acquire civil servant status without passing a formal examination, and the capacity of special-post office head has customarily been inherited by successive generations. Thanks to their long-standing history, former special-post-office heads form the largest support base of the LDP.

Two labor unions are associated with Japan Post, the Japan Postal Workers' Union (142,000 members) and the All Japan Postal Labour Union (87,000 members), which have been marching in lockstep in their opposition to privatization. Japan Post has a staff of 280,000, whose employment and civil servant status requires a difficult exercise of political judgment.

As mentioned above, postal system privatization aims to reduce dilated postal savings and postal life insurance operations, and reduce the volume of funds to government-affiliated special corporations. However, if the growth in new postal savings deposits were to decelerate and account cancellations to rise, it would impede the smooth placement of JGBs and introduce volatility to holding periods, possibly leading to a sharp increase in long-term interest rates. For this reason, it has been proposed to freeze existing deposits under government guarantee, and the JGBs in which these deposits are invested in government-administered special accounts.

Market clearance for JGBs will certainly become an important topic, and an abrupt reduction in JGB purchases or holdings by postal savings and postal life insurance systems with their enormous funds would instill panic in the market. However, it is a fact that fiscal discipline has been slackened by allowing policy objectives to rely on the funds from postal savings and postal life insurance. Should the government's response in this context come to be seen as lukewarm, this might cause public finances to miss their original purpose of letting market principles function. JS

(This is the last article of Tani Sadafumi's series)

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