Japan Post Reform: Return to Sender
By David A. Parker and Matthew P. Goodman
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Reform and privatization of Japan Post—Japan's largest bank, insurer, and public employer, as well as its postal service—has been a central issue in Japanese politics for more than a decade. Legislation passed by Japan's Diet on April 27 has rolled back the privatization process started under Prime Minister Junichiro Koizumi, underscoring the considerable political obstacles to badly needed economic reform in Japan.

To highlight the challenges posed by this new legislation, CSIS hosted a panel discussion on Tuesday, May 15, featuring several top experts on the postal reform issue, including Naoki Tanaka, former chairman of Japan's Postal Services Privatization Committee. Mr. Tanaka, whose second term as chair ended in April, described this latest development in the postal reform saga as a step backward, warning that "Japan Post belongs to the old governance system" and "will not [provide] impetus for the new development that Japan needs."

The restructuring and privatization of Japan Post was a central element of then–Prime Minister Koizumi's reform agenda in the early 2000s. Facing opposition even within his own Liberal Democratic Party (LDP), Koizumi dissolved the Lower House of the Diet in August 2005 to force a nationwide referendum on privatization. His bold move paid off, as LDP candidates handpicked by Koizumi were swept into office in a landslide, and the Postal Privatization Law passed in late 2005.

As called for under the law, Japan Post was split into four companies in October 2007—Japan Post Service, Japan Post Network, Japan Post Insurance (JPI), and Japan Post Bank (JPB)—with their shares held by a government-controlled umbrella corporation, Japan Post Holdings (JPH). JPH was required to sell off all of its shares in JPI and JPB by 2017, thus privatizing the two institutions.

The reforms came under attack with the victory of the Democratic Party of Japan (DPJ) in 2009 and its coalition with the People's New Party (PNP), a small party focused on reversing the Koizumi-era reforms. A PNP-drafted bill that would have allowed the government to maintain a one-third interest in JPH (and indefinite de facto control of the company) was only stopped by the surprise resignation of Prime Minister Yukio Hatoyama three days after it passed the Lower House. After little public debate, antireform legislation was revived earlier this year and passed on April 27 with only a single LDP abstainee. The new legislation eliminated the 2017 deadline for privatizing JPI and JPB and reversed other key elements of the Koizumi reforms.

As highlighted during the CSIS panel discussion, these developments represent a major setback to the longstanding efforts to reform Japan's outdated financial system, control systemic risk, and spur badly needed structural reform of the Japanese economy to make it competitive in the twenty-first century. Indeed, the new legislation is an equal mix of poor policy and bad strategy that has troubling domestic and international implications.

First, by indefinitely maintaining Japan Post as a government-controlled entity, the new law arguably raises financial system risks in Japan. As Gary Hufbauer of the Peterson Institute, another panelist at the May 15 event, pointed out, JPB's ¥177 trillion ($2.2 trillion) in deposits enjoy implicit unlimited support from the Bank of Japan. Approximately 75 percent of these deposits are invested in Japanese government securities, which helps keep interest rates on those bonds low. But this leaves them vulnerable to increases that would not only raise the Japanese government's borrowing costs but depress the value of JPB's bond holdings and threaten the postal bank's solvency, which the Bank of Japan would then have to act to head off. Against this backdrop, it is troubling that the International Monetary Fund chose to exempt Japan Post from stress tests under its recent Financial Sector Assessment Program.

Second, the new law tilts the competitive playing field between Japan Post and private banks and insurance companies. JPB and JPI enjoy light regulation and a number of other government privileges that give them a competitive advantage over private firms. The new law will make it easier for JPB and JPI to enter new lines of business and offer new products that compete with private products. It also mandates Japan Post to maintain a network of post offices that provide a range of financial services, allowing cross-subsidization of these activities, while effectively closing the door on distribution of private Japanese, U.S., and EU insurance products through the postal network. This threatens the $50 billion in annual sales by U.S. insurance companies in Japan, as well as the operations of private Japanese domestic insurers.

A third troubling implication of the new law relates to Japan's international commitments and interests. Warren Maruyama, another panelist at the CSIS event and former general counsel in the Office of the U.S. Trade Representative, noted that the advantages enjoyed by JPI and JPB represent a clear violation of Japan's obligations under the General Agreement on Trade in Services (GATS). Should JPI and JPB begin aggressively expanding their business and product lines, this would further damage economic relations with some of Japan's major partners and could invite an action in the World Trade Organization (WTO) by the United States, the European Union, or others.

The reversal of reform in this area also jeopardizes Japan's bid to enter the Trans-Pacific Partnership (TPP). Addressing U.S. concerns in the insurance sector was one of the "confidence-building measures" the Obama administration was seeking from Tokyo to make the case to Congress that Japan was ready to enter the trade talks; the new legislation has clearly undermined confidence in Japan's ability to engage constructively in the negotiations. Moreover, a key element of TPP is expected to be disciplines on state-owned enterprises (SOEs). Given the importance of these provisions to U.S. trade strategy more broadly, and the status of Japan Post as one of the largest SOEs in the world, the delay in privatization can only be seen as deeply troubling to the administration.

As proposed remedies, Hufbauer suggested a standstill on implementing key provisions of the new law as one measure that could mitigate the damage to Japan's TPP aspirations. In addition to signaling Japan's willingness to reform, this would also prevent private banks and insurers from being overwhelmed in the period between now and eventual privatization. However, this would not permanently solve the problem, which will only happen once the shares of JPI and JPB are fully out of government hands.

This most recent reversal is another indication of Japan's continued ambivalence about reform and its uncertain approach to jumpstarting economic growth. At a time when the country's share of regional trade is rapidly declining—and with it the ability to compel special treatment (particularly in trade negotiations)—the best Japan's politicians appear able to manage is kicking the reform can down the road. This not only threatens to hold back Japanese growth but also increases the risk that Japan will be left out of key regional integration efforts.

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