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# Japan Post Bank: Problematic Issues

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## Abstract

Japan, like many countries, has long offered savings deposits through the postal system. That system has undergone some reform over the past dozen years, and beginning in 2007 the system was to undergo privatization, with Japan Post Bank eventually becoming an independent entity. A new law passed in 2012 has stalled the privatization process. Regardless of how the issue of privatization plays out, the existence of a savings bank embedded within the postal system raises a number of troubling issues. This essay addresses five of those problems: a level playing field, market power, cross subsidization, social policy, and risk or inefficiency. These issues concern the fairness of competition within the banking industry, future financial stability of the Japan Post Bank, and broader economic inefficiency within the Japanese economy. This essay argues that government ownership of Japan Post Bank is unjustified on economic or social grounds. Complete privatization should resolve some of the problems, especially that of a level playing field. But issues of economic inefficiency and future financial stability could remain even after privatization.

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## **Japan Post Bank: Problematic Issues**

Edward J. Lincoln

Japan Post Bank is the largest bank in Japan measured by deposits and number of branches. The successor to the postal saving system, the Bank and the entire postal system have been undergoing reorganization for over a decade. The status and behavior of Japan Post Bank, as well as Japan Post Insurance, raise a number of issues and concerns for both domestic and foreign financial firms operating in Japan.

This essay addresses five problems or potential problems: a level playing field, market power, cross subsidization, social policy, and risk or inefficiency. Some of these issues are largely or entirely domestic, potentially affecting the future performance of the Japanese economy. Others are of actual or potential international concern, affecting the role of non-Japanese financial institutions doing business in Japan. Most of the issues of greatest concern to US financial institutions relate either to Japan Post Insurance or to the nature of the relationship among Japan Post Holdings (which owns the operating companies) and the constituent parts.

After providing some background on the postal system, Japan Post Bank, and Japan Post Insurance, successive sections address each of the five problems. The conclusion looks at three possible outcomes.

### **0.1 Background**

Japan established its postal system in 1871. In 1875 the government added postal savings, based on the system in Britain. The Post Office accepted deposits but did not lend out the funds on its own. Instead, all deposits were turned over to the Ministry of Finance (MOF) to be lent to public-policy projects. Over the years some minor changes occurred (particularly in the kinds of investments MOF could finance), but this arrangement remained in place until 2001. The MOF-run program that received the deposits from the Post Office (along with postal life insurance premiums and other funds) and lent them out was known as the Fiscal Investment and Loan Program (FILP).

In 2001 the government carried out a major overhaul of the system. Expanding an earlier permission dating back to the 1990s to invest a small share of funds on its own, the reform gave the Post Office authority to invest the funds as it wished rather than turning them over to MOF.

Public-policy borrowers that had formerly received funds through FILP would be financed either through their own individual bond issues (FILP Agency bonds) or out of a pool of funds raised by special MOF bond issues (FILP bonds). Thus, at least some of the organizations formerly receiving funds through negotiation with MOF would be required to issue their own bonds. (The Development Bank of Japan was a prime example).

The new system was implemented over a period of years, with a declining share of postal savings turned over to the FILP each year. By 2012, Japan Post had no funds deposited with the FILP.

The next round of changes for postal savings were part of the broader restructuring and privatization of the entire postal system. With passage of a privatization bill, postal savings was given its current name of Japan Post Bank Co, Ltd in 2007, one of four operating companies wholly owned by Japan Post Holdings Co, Ltd (JPH). Under this law, government ownership of the holding company was slated to fall to 33% by 2017, and over the same time period the holding company would sell 100% of the shares of Japan Post Bank (JPB) and Japan Post Insurance Co, Ltd (JPI) to the public.

Ownership of Japan Post Network Co, Ltd (owning and operating all the physical post office sites) and Japan Post Services Co, Ltd (mail delivery) would remain entirely in the hands of Japan Post Holdings. Under this plan, therefore, by 2017 JPB and JPI would have been completely privatized with no ownership links to the rest of the postal system or to the government.

However, implementation was put on hold when the Democratic Party of Japan (DPJ) came to power in 2009. Led by the DPJ, at the end of April 2012 the Diet enacted a law that effectively halted privatization. Under this law, several important parts of the 2007 plan were changed. The 2017 target for reducing government ownership of Japan Post Holdings to 33% was removed, as was the hold imposed in 2009 on sale to the public of JPB and JPI shares. In addition, the new law made explicit a requirement that JPB (and JPI) services be available at all post offices nation-wide. Also, effective October 2012, Japan Post Services and Japan Post Network were combined into a single firm (Japan Post Co, Ltd).

The lack of a time frame regarding the level of government ownership has been widely interpreted as a major reversal of the 2007 plan. The same applies to the shares of JPB and JPI: the hold on sale to the public has been removed, but there is no longer any time frame for reducing Japan Post Holdings' ownership to zero. While the LDP replaced the DPJ government on the December 2012 election, it is premature to make any appraisals as to how policy may change.

For those wishing additional background, a good overview of the postal saving system (PSS) and its reform is Doi 2009, p 284-88. Doi, a leading scholar of FILP, also covers that

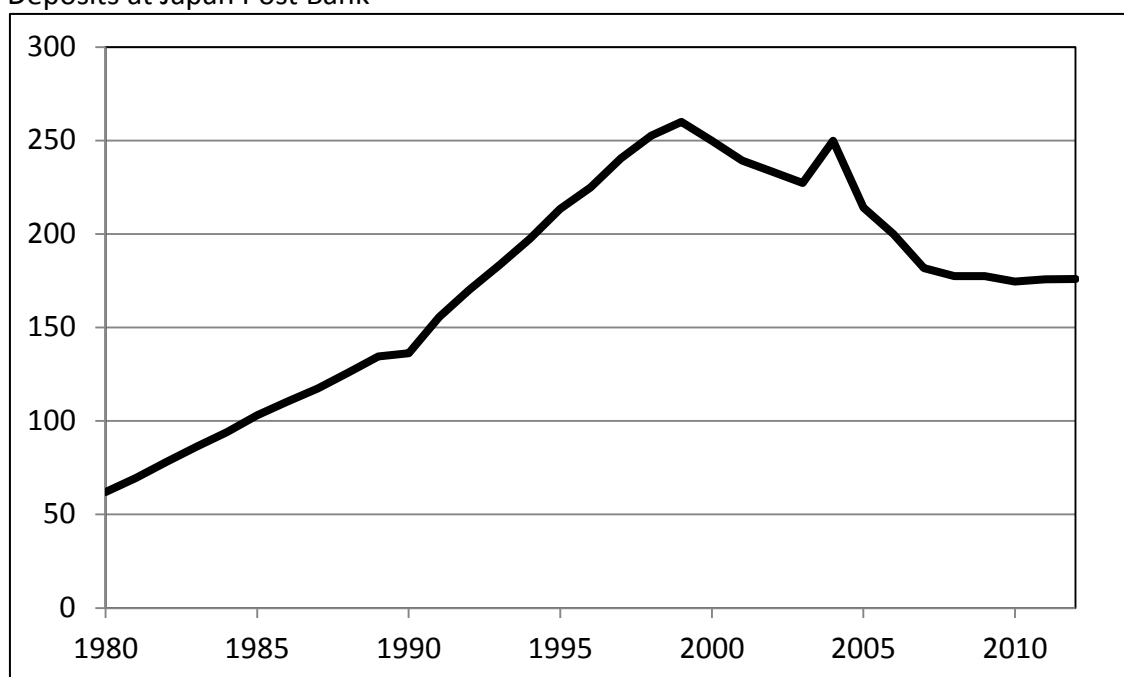
program in Doi and Hoshi 2003, Doi 2005, and Doi 2009. Also see Hoshi and Kashyap 2001, p 138-39, and its list of other sources.

## 0.2 Japan Post Bank

With about ¥176 trillion in deposits (\$2.1 trillion at then-current exchange rates) and 24,249 branches (March 2012), Japan Post Bank is the largest bank in Japan measured by deposits and number of branches. Deposit data are in Figure 1.

Figure 1

Deposits at Japan Post Bank



(trillion yen, as of March 31 of each year)

Deposits peaked at just over ¥250 trillion in 1998, and fell to ¥177 trillion in 2008, where the level has stabilized (¥176 in 2012). Deposits at commercial banks, on the other hand, continued to expand, rising 29% from 1998 to 2012. Even with the decline, JPB remains the largest depository financial institution in Japan.

Sources: *Japan Statistical Yearbook*, various years; Bank of Japan; Japan Post Bank “Financial Data, Summary of Financial results for the Fiscal Year ended March 31 2012”.

Like other banks, JPB offers a range of services to its depositors: savings accounts of various lengths (up to 10 years, which is longer than offered by commercial banks), ATMs, bill payments, transfers (both domestic and foreign) to other accounts, and credit cards (branded as Visa, JCB, and JCB EXTAGE). (Japan Credit Bureau (JCB), established in 1961, was an early provider of credit cards in Japan).

In addition, JPB provides internet banking through a PC or mobile phone. In the last quarter of 2011, JPB was offering discount deals for mobile phone service (KDDI's au plan), a home security firm (Alsok), and a cleaning service (Duskin).

Although individual loans are available, they are not heavily advertised, and such loans are a tiny portion of JPB's assets.

In other words, overall, except for loans, JPB offers a set of services quite similar to commercial banks. Users appear to be attracted by lower fees than at commercial banks for many of the services.

## 1 Level Playing Field

A firm with the backing of its government, especially through outright government ownership, enjoys an unfair competitive advantage over other firms. Privatization ideally levels the playing field. However, even under the 2007 privatization plan it was unclear whether the playing field would be completely level, and the legal revision in 2012 is likely to leave JPB with an unfair competitive advantage.

### 1.1 Regulation

Consider regulation: since 1998 commercial financial firms — but not the postal saving system — have been overseen by the Financial Services Agency (FSA), a stand-alone government agency that took over regulatory functions from the Ministry of Finance.

For postal savings, prior to 2001 what oversight authority there was resided with the Ministry of Posts and Telecommunication (MPT) — the ministry with overall oversight over the entire postal system. MPT became part of the Ministry of Internal Affairs and Communication (MIC) as part of the 2001 government reorganization.

In 2001 FSA gained supervisory authority over both JPB and JPI. However, JPB and JPI are not regulated by the banking bureau or insurance bureau of FSA. Instead, FSA created a new Office for Postal Savings and Insurance Supervision. This office regulates JPB, JPI, Japan Post Holdings (as a financial holding company), and Japan Post Network (as a contracted

provider of banking and insurance services). The office is small (13 people), and reportedly many of the officers are on loan or permanent transfer from MIC.

The existence of a separate office outside the regular banking or insurance supervision operations of FSA opens an obvious possibility for differential regulation. That possibility is enhanced by the presence of former or seconded MIC official who are highly likely to be more lenient than regular FSA bank regulators in their supervision of both JPB and JPI.

Differential regulation can confer an advantage in a number of ways: easier approval for new products or services (affecting insurance more than banking services) and more-lenient auditing relative to the situation for private-sector firms. FSA has established a record of stringent inspection and an active program of orders to firms to improve or alter various aspects of their behavior. These stringent standards are not being applied to JPB or JPI.

## 1.2 Deposit Insurance

Commercial banks annually contribute 0.84% of their average daily deposit balance during the year to the Deposit insurance system. Postal savings was exempt from until 2007 when JPB became a member of the Deposit Insurance Corporation (DIC). It now pays premiums like the commercial banks. In fiscal 2011, JPB paid ¥91 billion to DIC. Therefore, this aspect of the tilted playing field has been remedied.

However, one aspect of differential deposit safety remains. DIC guarantees deposits up to ¥10 million. In a controversial move in 2010, the government allowed JPB to permit deposits up to ¥20 million. Apparently the DIC guarantee still applies only to ¥10 million. Nonetheless, commercial banks in Japan argue that the public believes deposits in JPB enjoy an implicit guarantee from the government up to ¥20 million because Japan Post is entirely owned by the government. Perhaps that sense of guarantee would have dissipated with sale of the shares of Japan Post Holdings and the shares of both JPB and JPI to the public, but with the sales on indefinite hold, this unfair advantage for JPB remains.

Perhaps the increase in insured deposit size is partially responsible for the halt in the decline in the size of JPB deposits around 2010.

## 1.3 Perceived Risk

More broadly, commercial banks (and private-sector insurance firms) feel that the public perception of overall risk associated with JPB and JPI is lowered by government ownership. That is, whether deposits are insured or not, the public believes that JPB is safe since the government would never allow the bank to fail. Although JPB and JPI would have been entirely

free of government ownership in 2017 under the 2007 plan, bank and insurance companies with the name "Japan Post" would be inextricably linked in the mind of the public to the post office (which would still be one-third owned by government). In a similar way, Japan Airlines retained an image of being the national-flag carrier (and enjoyed the benefit of differential regulation) for a number of years after the government sold the last of its equity stake at the beginning of the 1980s.

#### 1.4 Japan Post Insurance

As to Japan Post Insurance (JPI), historically it was constrained on the types of life insurance it could sell, offering whole-life and endowment policies. One of the contentious issues regarding JPI, therefore, concerns granting regulatory approval for JPI to offer additional insurance products similar to those offered by commercial insurance firms. The lack of a level playing field has created strong opposition to JPI's expansion into new areas of insurance.

Holding companies cannot own both a commercial bank and an insurance company - except for Japan Post Holdings. Being able to offer both banking and insurance services in the same office is another manifestation of an un-level playing field.

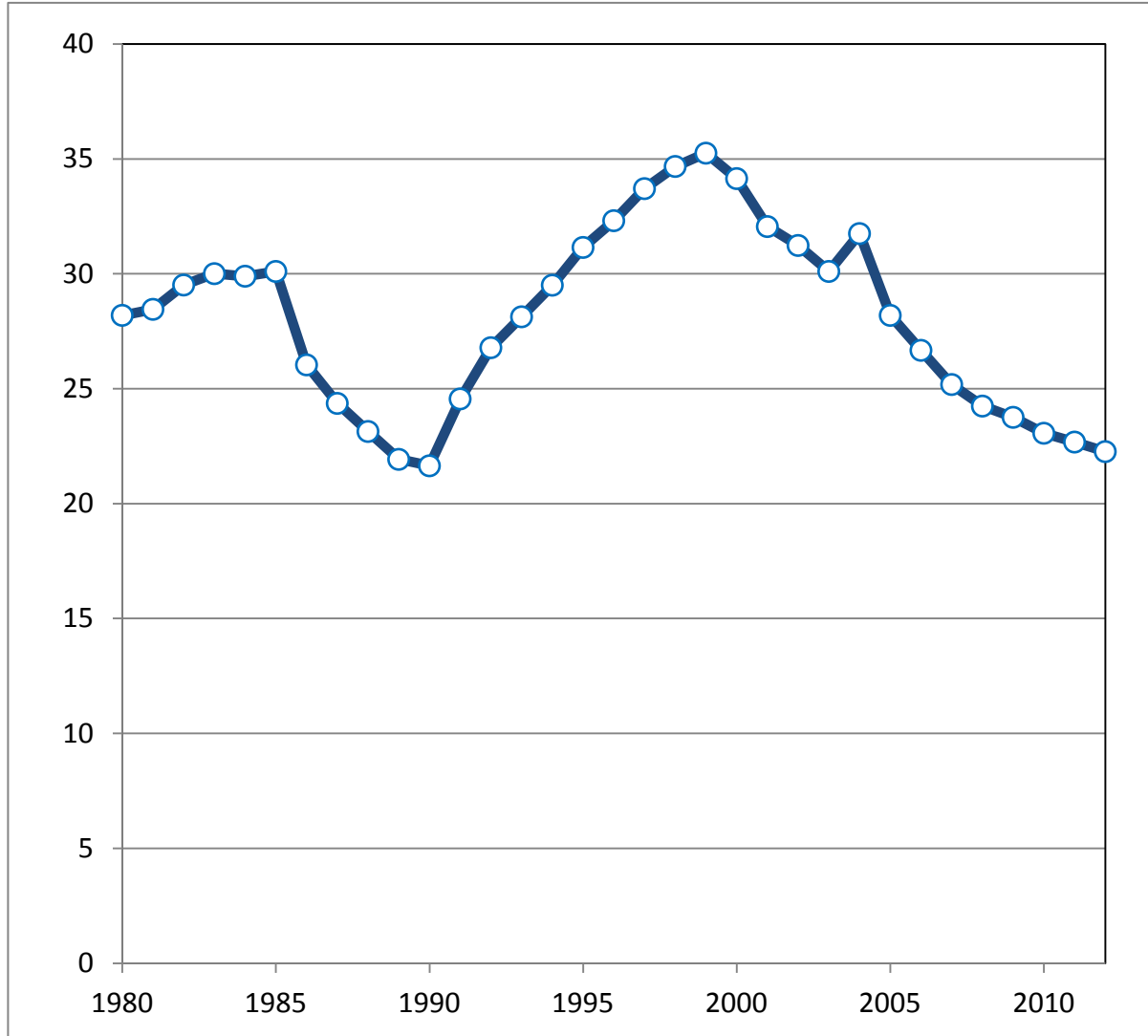
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Figure 2

Postal Savings as a Share of Total Bank Deposits

(percents, as of March 31 of each year)



Sources: *Japan Statistical Yearbook*, various years; Bank of Japan; Japan Post Bank “Financial Data, Summary of Financial results for the Fiscal Year ended March 31 2012”.

2 Market Power

Japan Post Bank has by far the largest share of deposits among banks in Japan, as shown in Figure 2. The ratio has fluctuated considerably since 1980. During the 1990s the ratio rose,

most likely as households became concerned about the safety of commercial banks, reaching 35% in 1998, and then drifted back down after 2000. As of March 2012, the ratio was 22%. This share is higher than that of any commercial bank in Japan.

Market share matters, and for a single firm to have nearly one quarter of the national market for bank deposits is high. However, the dominance of JPB's deposits should not be exaggerated. Consolidation of Japan's banking industry has resulted in a small number of large commercial banks. The largest, Tokyo Mitsubishi UFJ Bank, has a 20.7% deposit share; Sumitomo Mitsui has 13.7%; and Mizuho has 13.2%. So JPB is the largest, but no longer as much of a giant in a land of pygmies in terms of total deposits as was the case in the late 1990s when its share of total bank deposits peaked at 35% (although the data for the three commercial banks are for the financial group as a whole, rather than just the commercial bank subsidiary of the group).

The very large absolute and relative size of Japan Post Bank raises the question of market power.

Several decades ago, when controls on interest rates still existed, increasing deposit size was the primary way for banks to increase profits. Therefore, relative deposit size was important.

Savings deposits are a relatively undifferentiated product, but JPB continues to have several advantages in attracting deposits. First, it is the only bank with a 10-year savings deposit (with a guaranteed 10-year interest rate and no penalty for early withdrawal). Second, fees for many of its services are lower than those at commercial banks. Third, the presence of ATMs at most post offices across Japan provide a level of geographic convenience for deposits and withdrawals unmatched by any single commercial bank (though this advantage is finally eroding).

## 2.1 Relative Assets

Rather than size of deposits, perhaps it makes more sense to consider size in terms of total assets. On this basis, the big financial groups and their banking subsidiaries are close enough in size that JPB is best described as a participant in a close oligopoly dominated by four firms. Table 1 shows the total assets of the top 5 financial organizations in Japan.

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Table 1

Total Assets of the Largest Financial Institutions  
(2011 Mar 31, trillion yen)

Total Assets	Institution
193	JPB
206	Mitsubishi UFJ Financial Group
161	Mizuho Financial Group
138	Sumitomo Mitsui Financial Group
43	Resona Holdings

Sources: Mitsubishi UFJ Financial Group, Consolidated Summary Report for the Fiscal Year Ended March 31, 2012, p. 12, [http://www.mufg.jp/english/ir/fs/backnumber/2012mufg-mar/pdf/consoli\\_summary1203\\_e.pdf](http://www.mufg.jp/english/ir/fs/backnumber/2012mufg-mar/pdf/consoli_summary1203_e.pdf) ; Sumitomo Mitsui Financial Group, Consolidated Financial Results for the Fiscal Year ended March 31, 2012, p 10, [http://www.smfg.co.jp/english/investor/financial/latest\\_statement/2012\\_3/h2403\\_e1\\_01.pdf](http://www.smfg.co.jp/english/investor/financial/latest_statement/2012_3/h2403_e1_01.pdf); Mizuho Financial Group, Financial Statements for Fiscal 2011, p, 1-11, [http://www.mizuho-fg.co.jp/english/investors/financial/fin\\_statements/data11/pdf/fy.pdf](http://www.mizuho-fg.co.jp/english/investors/financial/fin_statements/data11/pdf/fy.pdf); Resona Financial Group, Consolidated Financial Results for Fiscal Year 2011, [http://www.resona-gr.co.jp/holdings/english/investors/financial/results/pdf/20120511\\_2a.pdf](http://www.resona-gr.co.jp/holdings/english/investors/financial/results/pdf/20120511_2a.pdf) (May 10, 2012).

Mitsubishi UFJ, JPB, Mizuho, and Sumitomo Mitsui are by far the dominant institutions, with next-largest Resona Holdings only one-third the size of fourth-ranked Sumitomo Mitsui. Collectively JPB plus the top-three private-sector institutions are in a position to make markets in Japan. The small number of institutions raises concerns about potential collusion. And within this tight oligopoly, JPB ranks as second largest.

Since the three large private-sector firms are financial holding companies, perhaps JPI's assets should be added to those of JPB in this comparison. However, none of the large holding companies includes an insurance firm, due to a prohibition of doing so in the 1998 law that enabled creation of financial holding companies. Indeed, yet another aspect of the un-level playing field, is the presence of both banking and insurance under the umbrella of Japan Post Holdings. If one does add the assets of JPB and JPI together, the total comes to ¥290 trillion, almost 50% larger than the assets of Mitsubishi UFJ Financial Group.

How might asset size matter? As long as JPB holds most of its assets in government bonds, market power would seem to confer little advantage. The most one can say is that the large purchases of government bonds contributes to low interest rates on those bonds.

What happens if JPB diversifies its investment portfolio, particularly into the area of corporate bonds and syndicated loans? JPB is sufficiently large that potentially its decision not to underwrite a bond or participate in a syndicate could be the decisive action in preventing the bond issue or loan from occurring. That is, JPB is so large that it can make (or break) the market, which raises traditional market competition concerns.

## 2.2 Implications of Market Power

To the extent there is a market-power issue, it is in a sense less an issue than 20 years ago when the relative size of JPB was even larger. However, in the past the issue really did not exist at all because the funds raised through deposits were turned over the Ministry of Finance for FILP investments that generally were independent of the kinds of investments made by commercial banks. Therefore, despite the decline in the relative share of JPB in terms of deposits, this concern is more relevant than in the past due to the bank's ability to invest its own funds.

What about oligopoly rather than individual firm market power? The top-four institutions represent 26% of assets of all financial institutions of all types according to Bank of Japan flow of funds data. (Total financial sector assets on March 31, 2012 are reported to be ¥2.7 quadrillion (¥2.8 total minus ¥0.1 for the Bank of Japan).) While that percentage might not seem overly high, it is the relative size of these four to any other financial institution in Japan that matters. Therefore, there should be at least some mild concern about oligopoly in the financial sector, and JPB is a major part of that concern. Even if JPB cannot influence markets on its own, collectively these four can. The fact that one of the four is government owned also raises the possibility of government manipulation of behavior for non-economic purposes, such as underwriting bonds for politically favored firms.

## 3 Cross Subsidization

The 2007 privatization plan was intended to establish four independent companies, all owned by Japan Post Holdings. Despite their common ownership, each was to behave as an independent profit-maximizing entity, with that behavior enhanced by divesting ownership of JPB and JPI by 2017. The post offices operated by Japan Post Network in this situation would have been free to sell financial products (such as insurance) offered by financial firms other

than JPI and JPB. Aflac, for example, worked out an agreement with Japan Post Network to offer some of its insurance products through post offices. That independence has been halted, informally since the DPJ took power in 2009, and more formally with the 2012 legal revision that makes complete divestiture of JPB and JPI uncertain for the indefinite future.

With less independence and less individual responsibility for profits, the pressure and opportunity to coordinate the behavior of the now-three companies owned by Japan Post Holdings increases. One obvious outcome will be to curtail expansion into business areas related to the other units (such as selling private-sector insurance policies at post offices). Another obvious outcome is the potential for coordinated investment behavior by JPB and JPI, so that perhaps Japan Post as a whole should be regarded as a financial group like the big three private-sector groups.

A third possibility is the use of pricing for cross-subsidization. Even under the 2007 system, plenty of opportunity existed for such practices.

At issue is the use of space and personnel in post offices owned by Japan Post Network in general, and for provision of banking and insurance services in particular. JPB and JPI contract with Japan Post Network for provision of over-the-counter banking and insurance services. But at what price? There is no market competition to set them. JPB does not have the option of, for example, contracting with convenience-store chain Family Mart to offer those services. Nor is Japan Post Network able to switch to offering over-the-counter banking services for a commercial bank.

In this incestuous environment, the decision on what price to set rests with Japan Post Holdings. In a large post office, it might be possible to have personnel who work full-time as bank clerks, but in smaller ones the same personnel split time among postal services, banking, and insurance activities. Accounting for the hours spent on each of the separate activities is possible, but one doubts that this is likely to happen. A similar problem exists for overhead. How much should JPB contribute to the overhead (implicit rent, utilities, etc)?

The situation actually might be working to the disadvantage of JPB, reducing its profits (and, therefore, the market power problem). That is, the main problem faced by Japan Post is the world-wide one of declining demand for postal services. From 2000 to 2009, the number of letters handled by the post office declined 21% and first-class letters by 25% (*Japan Statistical Yearbook* 2012). However, the number of post offices declined only 1%. The change in employment is a bit harder to estimate because employees listed as part of the postal system in 2000 are now split among five different organizations. However, it appears that total employment has fallen 19% from 2000 through 2011 (and presumably less than 19% through 2009). (Due to productivity increases, employment had been falling slowly over the previous decade even as mail volumes were rising.)

Japan Post, in short, has a serious problem of declining mail volume and revenue while maintaining a bloated number of post offices and excessive employment. In such circumstances, it may be tempting to subsidize postal services by charging JPB and JPI high fees for offering banking and insurance services at post offices.

Or, cross-subsidization could be working in the opposite direction. Even if the 2007 plan had continued to be implemented, it is possible that the privatized Japan Post Holdings could convince government that Japan Post Services deserves some form of government subsidy to cover the losses resulting from the decline in mail volume. Further, perhaps Japan Post Holdings would see some overall advantage to itself from enhancing JPB's competitive position in the banking sector. Thus, if government were to fill the fiscal hole for postal services, then JPB and JPI might be offered below-market fees for operating in post offices. The low fees would give JPB an unfair advantage over commercial banks that must pay competitive commercial rates for their branches.

The legal changes in 2012 make this system even more murky. By removing the requirement for privatization, the entire Japan Post system is in an even less arm's-length relationship with government, making the subsidization of money-losing postal services more likely, and increases the chance of creative accounting to create competitive advantage for JPB.

### 3 Social Policy

The most frequent political argument against privatization of the postal system as a whole, and Japan Post Bank in particular, is the need for provision of easily accessible banking and insurance services in rural parts of Japan. Rural villages, according to this view, are characterized by a lack of branch offices of commercial banks and the residents are disproportionately elderly people. These people are presumably less mobile than younger people (that is, they do not drive cars), and have used postal savings accounts as their primary savings vehicle for many decades. Therefore, access to nearby post offices for banking (and life insurance services) could be important for them. True privatization of JPB might lead to limiting the number of post offices in rural areas that offer JPB and JPI services, as such operations in lightly populated villages might be unprofitable, or to the outright closure of some rural post offices. With a lack of nearby commercial bank branches, and with less mobility, elderly people in rural areas, therefore, would be unfairly disadvantaged.

For starters, this potential social policy issue cannot be legitimately applied to JPI. Unlike banking, insurance services do not involve a need for frequent visits to an insurance branch office. Sale of insurance policies has typically involved agents visiting households rather than

clients visiting insurance company branches. Further, premium payments are easy to handle through automatic bank transfers. The same is true of payout on policies. Therefore, there is no necessary reason for close geographical access to over-the-counter JPI services.

For JPB, at least some of the claims are true. Thus, it is true that, relative to the nation as a whole, rural parts of the country are older and more lightly populated. In 2010, 23% of the population was age 65 or over. But in 9 predominantly rural (and mountainous) prefectures, the ratio was 26% or higher. (Japan has 47 prefectures.) The towns themselves tend to be smaller. So, it is entirely possible a profit-maximizing firm might close branches in such areas.

JPB operated 24,248 branches in 2011, including 234 branches of its own and 24,014 "contract" branches in post offices. Commercial banks collectively operate a total of 13,482 branches, just over half the number of JPB.

Post offices (and, hence, JPB) are intended to be geographically convenient. They thus inherently accommodate lower population density in the national distribution of branches. The average post office in Hokkaido serves 3,692 people, while the average post office in the Kanto region (Tokyo, Kanagawa, Chiba, and Saitama prefectures) serves 6,976. (On the other hand, most Kanto residents are within walking distance of a post office; that is not true in Hokkaido.) A profit-maximizing organization might be likely to cease service at some rural locations.

#### 4.1 Other Ways to Address Social Policy Concerns

On the surface, therefore, the social policy concerns of those who oppose privatization appear to have some legitimacy. However, there are three important objections to the concerns. First, the theory of appropriate policy actions points to alternative solutions. Second, the social rationale for providing banking services at rural locations is not even clear cut. Third, the policy substitutes an (alleged) inequity with a real one: JPB must penalize other depositors in various ways in order to generate the funds to meet the social policy requirement.

The concept that people throughout a nation deserve easy geographical access to government-provided postal services has been commonplace since the 19th century in many parts of the world. But, do banking services deserve the same government treatment? In a cash-based society, it is certainly important that people have easy access to either bank branches or ATMs to withdraw cash (and to make deposits if they have cash receipts rather than automatic deposits by their employer). And if people hold their household financial assets in the form of savings accounts at banks, periodic access to a bank is similarly important. Relative to the United States, Japan has been more cash-dependent, although the reliance on cash has been changing with increased use of both credit and debit cards. Japanese households also hold a far higher share of their financial assets in the form of savings accounts. Older

people are probably more likely to use cash than younger people. These features of Japanese society suggest that easy geographical access to bank branches might indeed be important.

However, these basic banking functions can be undertaken at ATMs; a branch bank is not necessary for most transactions. The author, for example, has walked into a bank in the United States to conduct business over the counter only once in the past five years. Perhaps one could argue that elderly people are less likely to be comfortable with operating ATMs, but there comes a point in evolving technologies when it is no longer reasonable to maintain older interfaces. Therefore, it would make more sense for small rural communities to be served by ATMs located in those places of business (such as supermarkets or convenience stores) where people go on a regular basis to shop. Maintaining JPB over-the-counter services at virtually all post offices is unnecessary in the 21st century. This conclusion is particularly true given the data on ATMs in Japan, shown in Table 2.

Table 2

Installed ATMs

Type of Institution	Number of ATMs	Share of total (%)
Agricultural Cooperatives	12,532	7
Labor Banks	2,028	1
Credit Cooperatives	2,286	1
Shinkin Banks	19,927	11
Total Private Sector:	112,836	64
Japan Post Bank:	26,331	15
Total	175,940	100

Data are for March 31, 2009.

"Payment Systems", Japan Bankers Association, [http://www.zenginkyo.or.jp/en/banks/payment\\_systems/index.html](http://www.zenginkyo.or.jp/en/banks/payment_systems/index.html), and Japan Post Bank, Annual Report 2011, p. 10 (April 18, 2012).

Although the geographical distribution of these ATMs is not available, the large number would suggest that access to ATMs even in rural areas ought to be relatively easy. To be sure,



most ATMs are located at the site of bank branches, so that if a commercial bank is not in a rural village, there may not be an ATM machine either.

#### 4.2 Rural Alternatives to JPB

The rural-need argument is significantly undermined by the existence of several alternatives to JPB. These are the ubiquitous convenience stores with ATMs, and the financial operations of local agricultural cooperatives.

Convenience stores offer an interesting parallel to post offices. Food items justify the existence of the outlets, but the stores can benefit by offering additional goods or services at marginal cost (that is, without contributing much to the general overhead of maintaining the outlets). Thus, the stores have copy machines, ATMs, and accept over-the-counter payment of a variety of utility bills. They also serve as the delivery point for packages.

The largest retailer in Japan is Seven and i Holdings, which owns 7-Eleven, Sogo Department Store, and Ito Yokado. It also owns Seven Bank, which is rather different from other commercial banks. Although it does accept deposits from customers, Seven Bank's main offering is ATMs that bring up the customized screens for whichever of 567 other financial institutions the customer's bank card represents. That means most of its income comes from ATM fees. Seven Bank operates 16,632 ATMs located mostly (but not exclusively) at 14,884 7-Eleven convenience stores. (Data are for March 2012.) Seven Bank plans on further increasing its number of ATMs. Operating nation-wide, many of the ATMs are in rural areas, and unlike JPB ATMs in rural areas, Seven Bank's are open 24 hours a day, every day of the year. (By law, a holding company is not supposed to own both financial and non-financial companies. In a way that is unclear, Seven and i Holdings has seemingly sidestepped this.

The other major convenience store chain, Family Mart, also operates its own ATMs (which numbered 7,515 in 2011), but not as a bank.

Rural areas have long been served by the financial operations of local agricultural cooperatives. In fact, in some rural towns it is the agricultural cooperative that has the contract to run the local post office. The cooperatives operate 12,532 ATMs. The association of agricultural cooperatives is sufficiently concerned by the competitive threat from JPB that it registered strong objections when the bill modifying privatization was submitted to the Lower House of the Diet in March 2012 (JA Group 2012).

#### 4.3 The Rule of Specificity

Despite the alternatives, and in the face of opposition from the politically potent agricultural cooperatives, the April 2012 law effectively halting Japan Post privatization also requires banking services at all post offices. But requiring JPB to provide its current level of post office bank branches is not the best way to achieve the claimed social goal of helping the elderly.

Economists have a theory known as the Rule of Specificity: "The optimal policy for correcting a[n economic] distortion is one that deals most directly, or specifically, with that distortion (Deardorff's Glossary)." This is used most commonly in international economic theory to explain why a tariff to correct a domestic economic distortion due to externalities is not the right choice. (See, for example, Pugel 2007, p 292-314).

To illustrate, Japan maintained a strict quota for many years on the importation of leather shoes to protect a minority group in society that suffered social discrimination and dominated production in the shoe industry. The rule of specificity says that the better social policy (that is, better for total national economic welfare) would be to subsidize domestic production of the product or provide an income subsidy rather than to inhibit imports (and thereby raise prices to consumers).

The rule can be applied to the JPB case. If Japanese society decides social equity requires that less-mobile elderly residents in rural areas have ease of access to banking services, then society should provide direct aid to those particular people. And why limit easier access to banking? If immobility of the elderly is truly a problem then society ought to provide free or subsidized transportation for a range of activities. Thus, trips to medical facilities, drug stores, and other shopping should be covered. And not just in rural areas.

For the elderly (rural or urban) who find the technology of ATMs overwhelming, personal services to carry out transactions on their behalf might also be possible.

From the banking industry's standpoint, the fact only JPB offers both convenience (in terms of location) and assistance in transactions skews the choice of where to maintain a savings account away from commercial banks toward JPB.

Therefore, the economically efficient solution is to provide personal assistance to those in society who need it, funded directly by taxpayers (that is, as an explicit government budget expenditure).

## 5 Inefficiency and Risk

For more than 130 years, the postal savings system collected deposits nation-wide through its post offices and turned the money over to the Ministry of Finance. With some administrative changes and then the major shift in the structure of the Fiscal Investment and Loan Program,

Japan Post Bank now has the authority to invest as it desires. This raises two closely related issues: inefficiency and risk.

So far, Japan Post Bank has continued to put the overwhelming portion of its funds into government securities, both central and local, as shown in Table 3.

Table 3

Distribution of Japan Post Bank Assets by Type (percents)

2008	2009	2010	2011	
73.9	79.1	80.1	75.7	Central Government Bonds
3.5	3.2	2.7	2.9	Local Government Bonds
3.7	5.3	6.3	6.2	Japanese Corporate Bonds
0.2	0.8	2.5	5.2	Other Securities
1.8	2.0	2.1	2.2	Loans
16.8	9.6	6.4	7.8	Other
212.1	196.5	194.7	193.4	Total Assets (trillion yen)

Data are for fiscal years ending Mar 31 of the following calendar year.

Sources: Japan Post Bank Annual Report, 2008 (p 58), 2010 (p 68), 2011 (p 45).

In March 2012 JPB announced that it would increase its government bond holdings during fiscal 2012. JPI has behaved quite similarly to JPB; in 2011 it held 73% of its assets in the form of central and local government bonds.

There has been a change in the composition of JPB's asset mix. Corporate bonds and "other securities" (mostly foreign bonds, presumably mostly US Treasury bonds) have increased share, while "other" assets were losing share until 2011. This last category consists mainly of loans to the Fiscal Investment and Loan Program, which had been decreasing steadily since the overhaul of FILP in 2001.

Let us consider two scenarios: in one, JPB continues to hold mostly government bonds; in the other, it cuts bond holdings in favor of other forms of investments.

If government bonds continue to dominate, then, in essence, JPB acts as a means to put household savings into government bonds. It holds more government bonds than any other financial institution in Japan. On March 31, 2011, JPB held 25% of central government bonds

not held by the central bank, and JPI held 11%. Therefore, JPB plays a significant role in enabling the Japanese government to finance its deficits.

Because JPB is government owned, its purchase of government bonds is not exactly a market transaction. That is, it is not clear whether JPB buys these bonds because it is a profitable way to use its funds or because it is under pressure to aid the government. The fact that JPB holds a much higher percentage of central government bonds in its asset portfolio than do commercial banks suggests the presence of pressure (and perhaps reflects a recognition of its own lack of expertise in investing in other financial instruments). In this role, JPB is helping to postpone the day when the government faces market resistance to further bond issues, causing interest rates to rise (and bond prices to fall). Perhaps it is best that this day be postponed. But, it might be better for the government to face the need to reduce deficits sooner rather than later. If this is the case, then JPB is causing inefficiency in the economy by postponing needed policy changes.

Keeping the overwhelming majority of assets in the form of government bonds also raises the question of stability. Interest rates on government bonds have been very low since the late 1990s. At some point, however, if the government fails to reduce its large annual deficits, the day of reckoning will arrive and interest rates will rise. As interest rates rise, the price of bonds falls, lowering the valuation of JPB's bond holdings. This phenomenon should not matter if JPB simply holds bonds to maturity, at which point it receives the face value of the bonds. But accounting standards do not work that way.

Further, if JPB sticks with its bond portfolio as interest rates rise, it will be squeezed between the low returns on its existing bond holdings and the need to raise the interest rates it pays on deposits in order to be competitive. This problem faces most Japanese banks, but JPB in particular. If deposit rates rise in tandem with rates paid on newly issued bonds, JPB could face a deficit. Therefore, the very large share of government bonds in the asset mix of JPB raises substantial risks going forward.

In contrast, commercial loans were 50% of commercial bank assets in 2011. Government bonds (central and local government) have increased share over the past decade, but were only 19%.

If JPB were to gradually move toward an asset allocation closer to that of commercial banks, it would decrease its holdings of government bonds and increase lending.

Altering the composition of assets is the explicit intent of the bank, according to the statement on business strategies on the bank web site: "Japan Post Bank will disperse risks and diversify earnings sources, by diversifying means of investments (into trading of derivatives, acquisition and sales of monetary credits, syndicated loans, securitized products, beneficiary

rights, and investments in stocks), while controlling interest rates-associated risks appropriately.”

All of the possible investment activities other than just sticking funds into government bonds require training and skill. JPB managers have never had the necessary training, so the potential for costly mistakes is high.

At best any reallocation involves inefficiency in the provision of credit, lowering returns for the bank and extending excess credit to undeserving borrowers. At worst, the inability of borrowers to repay could jeopardize the financial stability of JPB. After all, if JP Morgan Chase (a supposedly highly sophisticated bank) could lose \$2 billion in two weeks using relatively routine trading practices, just imagine what JPB could do.

One particular source of concern is lending. Loans in 2011 were a tiny 2% of JPB’s total assets. The bulk of these were to the finance and insurance sector (67% of outstanding loans) and central and local governments (14%). Loans to individuals and medium and small companies were only 2% of total loans (Japan Post Bank 2011, p 88-89).

Even though lending has been minor, the long history of post office (that is, local postmaster) involvement in local politics provides a reason for concern about loans to individuals and small business, as well as loans to local governments (given the very poor financial condition of many rural towns and villages). So far, these loans are such a tiny share of total assets that the risk might seem negligible. Even if loans are too small to increase the systemic risk of JPB, they are certainly large enough to do some mischief at the local level if loans are made for political or other non-business reasons. Any increase in the loan portfolio should be a cause of concern.

## 8 Conclusion

Japan Post Bank raises a number of troubling issues. The best outcome would be to simply dismantle both Japan Post Bank and Japan Post Insurance. That is, JPB would stop accepting new deposits so that deposits eventually dwindle to zero. JPI would stop writing new insurance policies, and cease doing business as the last policy is paid off. Post offices would then be able to contract with any private-sector firm to offer the firm’s products over the counter. Competition for access to the physical locations would ensure that Japan Post charges market rates for space and personnel. This solution is obviously much too radical: at no point in the political debate on their future has there been any serious proposal to put JPB and JPI out of business.

The second-best solution is the 2007 deal. Although concerns over cross-subsidization would remain, privatization along the lines envisioned in 2007 would address some concerns about a level playing field. Even better is for supervision of both JPB and JPI to be handled in the same way as for their competitors rather than through a special office in the Financial Services Agency. Complete privatization of JPB might eventually cause public belief in an implicit government guarantee to evaporate (as it did eventually in the case of Japan Airlines). Allowed to pursue profits, JPB might drop banking services in some rural locations, pushing the government toward the appropriate policy to assist elderly people. Market power issues would remain (though somewhat contained if the playing field were truly leveled for both JPB and JPI). Cross subsidization would be a possibility until the holding company sold off all shares of JPB and JPI, but presumably not thereafter. Incompetence leading to inefficiency and financial losses would still be a problem, but the pressures of the market could conceivably drive both JPB and JPI to acquire the necessary investment competence. Therefore, this solution is imperfect, but would at least partially address the five concerns raised in this essay.

The worst outcome is the one brought about by the legal changes of 2012. The playing field is more likely to remain tilted because of the government-owned nature of Japan Post. That favoritism exacerbates market power concerns (as in the 2010 decision to permit a higher ceiling on JPB deposits). The sense of entitlement implicit in the legal change of 2012 strongly suggests that lenient regulatory supervision by the FSA will continue to be a problem. The reduction in independence of the constituent parts of Japan Post increases the probability of cross-subsidization. Misguided concerns about services in rural areas will continue to saddle all three firms with inappropriate costs. Finally, the combination of actual government ownership and the vague sense of social purpose (serving rural areas) lowers the probability that JPB or JPI will invest responsibly. All private-sector commercial banks and insurance companies operating in Japan are disadvantaged by this situation. Further, the economy as a whole is harmed by inefficiency as funds are misallocated and as Japan Post continues to bear the cost of rural services. And if JPB or JPI fails to invest its funds wisely, taxpayers will be saddled with yet another expensive collapse.

Postal Savings has a long history in Japan, and changes arising from reform could bring a major alteration in behavior. Even prior to the changes that began in 2001 there were reasons to be concerned about the role and behavior of what is now Japan Post Bank. But the FILP changes, the restructuring of the Post Office, and the now-uncertain status of privatization exacerbate existing issues and have created new ones. Fundamentally, all of these issues concern the problems and economic distortions arising when government competes in markets that are well-served by the private sector. The five issues raised in this essay do not depend entirely on whether or not privatization goes forward. Even with complete privatization as

planned in the 2007 law, concerns would remain due to residual regulatory favoritism and risk from incompetence. That said, the backtracking in 2012 is likely to exacerbate these concerns.

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