



Turning Back the Clock: Japan's Misguided Postal Law is Back on the Table

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On October 8, 2010, the Japanese Cabinet approved legislation that would reverse a decade's worth of effort to fully privatize key subsidiaries of Japan Post Holdings Co. Ltd. Besides postal services, the state-run postal system offers banking and insurance services, through Japan Post Bank (JPB) and Japan Post Insurance (JPI), respectively. These are the financial engines of Japan Post and were the units slated for full privatization. Both subsidiaries have long received favorable government treatment, tilting the playing field against private banks and insurance firms, whether foreign or domestic. The government of Japan is in clear violation of its commitments under the World Trade Organization (WTO), and if the Diet passes the legislation, Japan will reverse the efforts made by the United States and the European Union, as well as domestic private banks and insurance firms, to establish a level playing field. What's more, Japan risks having a formal WTO dispute brought against it.

Former LDP Prime Minister Junichiro Koizumi made privatization of Japan Post a signature issue. In 2005, a bill to fully privatize Japan Post was passed, and by October 1, 2007,

the state-run postal service was split into four companies under the umbrella of Japan Post Holdings Co. Ltd. The new companies are Japan Post Service, Japan Post Network, Japan Post Bank, and Japan Post Insurance. Under the Koizumi reforms, privatization of JP Holdings and the two financial subsidiaries was scheduled for completion by 2017.

In August 2009, the Democratic Party of Japan (DPJ) came to power led by former DPJ Prime Minister Yukio Hatoyama, after campaigning for the reversal of the Koizumi reforms. Together with kingmaker Ichiro Ozawa, then secretary-general of the DPJ, and Shizuka Kamei, then-minister of state for financial services and postal reform, Hatoyama was well on his way to achieving this objective. On May 31, 2010, with almost no debate, the Lower House approved the legislation to reverse the Koizumi plan. The legislation would restructure JP Holdings and allow the government to hold one-third of its shares indefinitely, essentially a controlling position. Under the new legislation, JP Holdings, Japan Post Service, and Japan Post Network would be merged into a single holding company. JPB and JPI would then be subsidiaries of the newly merged parent company, with at least one-third of their shares held indefinitely by the holding company.

Following Hatoyama's surprise resignation on June 2, it was unclear what the fate of the postal legislation would be. As long as Hatoyama was prime minister, the government hoped to pass the bills before the Diet adjourned on June 16. However, on June 10, the DPJ, led by Hatoyama's successor Naoto Kan, announced that consideration of the postal bills would be postponed until the next Diet session. The next day, Kamei, chief architect of the bills, announced his resignation from the cabinet.

Kamei, however, was able to arrange for then-secretary-general of the People's New Party (PNP), Shozaburo Jimi, to be named as his successor. And the legislation has been submitted to the Diet in nearly identical form (only the implementation date has been changed), with the Government having placed the bills at the top of its legislative agenda for the current Diet session. In addition, Prime Minister Kan as well as Minister Jimi and MIC Minister Yoshihiro Katayama have pledged to do everything in their power to achieve prompt passage of the legislation.

The current draft of the postal legislation is designed to tilt the playing field even further in favor of Japan Post and

clearly violates Japan's commitments in the WTO. Consequently, the United States and the European Union have vigorously lobbied the Japanese government to reconsider the Japan Post bills, even to the point of holding joint high-level WTO talks with Japan in Geneva. This suggests that without dramatic changes by Japan, things are headed toward a formal WTO dispute, one which Japan would likely lose.

PREFERENCES TILTING THE PLAYING FIELD

At the end of the second quarter of 2009, employment in JP Holdings and its subsidiaries numbered 226,000, a roster that makes the company a potent force in Japanese politics. With ¥177 trillion in deposits (roughly \$1.9 trillion), JPB is the largest financial institution in the world. It holds approximately 31 percent of Japan's total bank deposits and maintains the nation's largest network of branches, all nestled in post offices. JPI is Japan's largest insurance provider, with ¥7.9 trillion (about \$86.6 billion) of annual premium income, effectively controlling 23 percent of the domestic market. Together, these two companies have assets of more than \$3 trillion. Both receive preferences that allow them to operate outside the normal regulatory framework.

These preferences include:

- preferential (near-exclusive) access for provision of savings deposits and insurance services through the post office network;
- exemptions from a range of provisions under the Insurance Business and Banking Laws, including from licensing requirements and bank and insurance holding company rules; and
- exclusive access by JPI to subsidized revenues from over 50 million government-guaranteed and privileged insurance policies sold by Japan Post prior to October 2007. These and other preferences give JPI and JPB a decisive and unfair advantage over private banks and insurance firms in market access, regulation, and financial credibility.

Market Access

The mandate of JP Holdings is to provide the "largest collection and delivery networks [...] continuously providing universal services." Through the Japan Post network of roughly 24,500 post offices located in all 47 prefectures, JPI and JPB have preferential (near-exclusive) access for the provision of savings deposits and insurance services. By contrast, private insurers have access to just 1,000 post offices, in which they are permitted to sell only a limited range of policies (term life

and supplemental insurance), whereas JPI, which operates in over 22,000 post offices, has the right to sell its entire range of products. The ability to provide banking and insurance services through the government-owned post office network allows JPB and JPI to capture a large segment of the market due to the impression that their financial services are government-guaranteed, as they were until recently.

Regulatory Framework

As public entities, JPI and JPB are exempt from the rigorous regulatory oversight that all other banks and insurance companies must face. The Financial Services Agency, responsible for the regulation of all banking and insurance services, supposedly regulates JPB and JPI. However, JPI is granted preferential treatment through exemptions from the Insurance Business Law, which governs the actions of all other private insurers. Private insurance companies (domestic and foreign) are subject to strict licensing requirements as specified in Chapter I, Article 3(1) of the Insurance Business Law, which states:

[N]o insurance business may be operated without having obtained a license from the Prime Minister.

JPI is exempt from these requirements, being entitled to fully engage in the life insurance business through the legislative grant of a "deemed license" without undergoing the licensing pre-approval process that private insurers face. Unlike private sector insurers, JPI's license is not revocable.

Financial Credibility

Kampo and Yucho, predecessors of JPI and JPB, enjoyed a government guarantee of full payment to all holders of insurance policies and savings deposits. Kampo was also not obligated to make payments to the Life Insurance Policyholder Protection Corporation, unlike all other domestic and foreign companies, which must pay insurance premiums under the terms of the Insurance Business Law. Similarly, Yucho was not obligated to pay deposit insurance premiums to the Bank of Japan. The Life Insurance Association of Japan estimates that Kampo saved ¥92.2 billion (about \$1 billion) between 1993 and 2002, while payments by private insurers amounted to ¥638 billion (roughly \$6.9 billion) during that same period. The Koizumi initiative has eliminated the government guarantee of full payment to all holders of JPI insurance policies and JPB savings deposits. However, both companies continue to enjoy a "de facto" government guarantee as they remain 100 percent government-owned-and-controlled entities and are the very definition of "too big to fail."

WTO AND BILATERAL COMMITMENTS

Japan did not take an exemption when it signed the General Agreement on Trade in Services (GATS) in 1994. Thus, from the first days of the WTO era, the operations of Japan Post and its financial units were inconsistent with National Treatment Article XVII:1 of the GATS, which states:

[E]ach Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers.

Article XVII:3 goes on to explain:

[T]reatment shall be considered to be less favorable if it modifies the conditions of competition in favor of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

Private foreign banks and insurance firms suffer no more discrimination from Japan Post's dominant position than private domestic banks and insurance firms—both groups have been seriously disadvantaged. However, the language of GATS Article XVII clearly shows that the current operations of JP Holdings have been inconsistent with Japan's international commitments. The proposed postal legislation now contains

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elements that are *newly inconsistent* with the government of Japan's national treatment obligations under the *GATS*, thereby threatening to not only derail the Koizumi reform train but also exacerbate existing violations of Article XVII by the Japanese government. At issue is not only a debate between Japan on the one hand and the United States and the European Union on the other. It is also a question of leveling the playing field for private insurers and bankers, whether domestic or foreign. The United States and the European Union worked for years to get the Japanese government to implement reforms, and Koizumi's proposed privatization plan was in part designed to respect Article XVII and level the playing field for all private firms. However, the new legislation will reverse these efforts to create a fair and competitive market.

The proposed postal legislation would not only further violate Japan's commitments under GATS but also set a dangerous precedent for other Asian countries, notably Korea and China, which all operate similar "all purpose" postal services.

The United States has a clear interest in the Japanese banking and insurance markets. At the end of 2009, US foreign direct investment stock in the Japanese financial and insurance sector was approximately \$29 billion. US balance of payments earnings for financial services in Japan were \$1.2 billion, plus another \$0.9 billion for insurance services. US insurance companies account for 12.2 percent of the Japanese life insurance market. Under the new legislation, US firms would face substantially increased competition from JPB and JPI, which already benefit from a range of favorable provisions uniquely accorded to them by the government, as described earlier.

REVERSALS UNDER THE NEW LEGISLATION

Under the new postal legislation, the preferences that JPI and JPB already enjoy will become more pronounced. The government will retain a minimum one-third share of the restructured JP Holdings, and the caps will be raised from ¥13 million (\$140,000) to ¥25 million (\$270,000) for insurance policies and from ¥10 million (\$100,000) to ¥20 million (\$220,000) for savings deposits. Moreover, JPI and JPB will be able to expand their scope of business. The current regulatory framework requires *approval* by the Financial Services Agency and Ministry of Internal Affairs and Communications, which are required to "listen to the opinion" of the Postal Privatization Commission before new lines are offered. Under the new bills only a *notification by JPI* is required. Cross-subsidization between entities under the JP Holdings umbrella would also be made easier under the proposed legislation.

These prospective changes rightly alarm private insurance companies and banks. For private insurers the more lenient requirements for JPI business expansion, coupled with a doubling of the JPI insurance cap, would give JPI the advantage of underwriting a range of new products. The lopsided regulatory environment would also allow JPI to increase its market share in new sectors while limiting the operational freedom of private companies. For the banking industry, the doubling of deposit limits, coupled with the *de facto* government guarantee, could prompt a shift of funds from commercial banks to JPB.

SETTING A PRECEDENT?

Korea, China, and India all have postal companies that offer banking and insurance services. All three are signatories to GATS. Among these, Korea is the only one that scheduled

exemptions in financial services. Korea's exemptions fall under the GATS Most Favored Nation (MFN) Article II and relate to banking and other financial services. Its schedule of exemption states that:

[F]uture liberalization measures affecting the entry and provision of financial services in or relating to the Republic of Korea will be granted only to those countries that accord MFN treatment to financial services or financial service suppliers of the Republic of Korea.

Korea's reciprocal exemption applies to all countries and is indefinite. In addition, Korea scheduled limitations on national treatment under its GATS commitments with respect to business operations.

While China did not schedule any exemptions, the implementation of its commitments has come under scrutiny. Under China's schedule of commitments, foreign life and non-life insurers and insurance brokers are permitted to provide services in specific cities but with limitations on the scope of life insurance products. China's commitments to liberalize banking and other financial services have similar restrictions. These limitations are to be phased out over time; however, China's compliance has been questioned. US and EU disputes have been lodged in the WTO concerning measures affecting foreign suppliers of financial information services (e.g., Reuters and Bloomberg) and credit card processing services.

China Post Group includes China Post Savings Bank (CPSB) and China Post Life Insurance (CPLI). While both companies are fairly new (CPSB was launched in early 2007 and CPLI was approved in September 2009), their goals are similar to that of Japan Post: establishing the largest banking and insurance network in the country. CPSB is already the country's second largest bank in terms of outlets and fourth largest bank in terms of deposits, totaling roughly \$290 billion in 2009.

Korea and India have similar systems, and while their postal savings banks and postal insurance providers have not achieved the scale of JPB and JPI, they have taken advantage of their expansive postal networks to capture remote rural markets. If the new bill for JP Holdings is passed, then Korea, India, and especially China, may pursue similar regulatory protection.

CONCLUSION

Japan's proposed reversal of the Koizumi postal reforms and its refusal to consider the interests of private banks and insurance firms are bad news for the existing trading system and rules

of liberal services trade. The exclusion of the world's largest financial entity from rigorous oversight generates systemic risk, and this risk would dramatically increase if JPI and JPB were permitted to enter into new business areas such as lending without the appropriate know-how. Even Bank of Japan Governor Masaaki Shirakawa has noted as much on more than one occasion. Additionally, the diversion of even more resources from the Japanese private sector into the funding of government products will only contribute to the continued stagnation of the Japanese economy.

Moreover, Japan would be setting a dangerous precedent for other Asian countries. The Japan Post reform legislation would create a system that allows JP Holdings to dramatically expand its dominance in banking and insurance. If Japan goes down this road, other Asian powers will surely take note, and some will be tempted to emulate the Japanese example. This would truly represent a major step backward for the global economy.

If the Diet passes the postal legislation, Japan would expand the violation of its obligations under the WTO, ignore its G-20 commitments to resist protectionism, and alienate its close economic partners in the United States and Europe. All this would occur during Japan's 2010 hosting of Asia-Pacific Economic Cooperation (APEC), including the Economic Leaders' Meeting, which will be attended by President Obama and many other heads of state. It will also come at a time when Japan is weighing whether to join the Trans-Pacific Partnership (TPP) in order to shore up its alliance with the U.S. and reinvigorate its domestic economy. Passage of WTO-inconsistent postal reform legislation would send a negative signal about Japan's willingness to undertake serious FTA commitments, which go above and beyond WTO.

In 2011, the hosting of APEC will shift to the United States, which can be expected to promote an agenda that includes high-standard Asia-Pacific economic integration. In addition, efforts to bring the Doha Development Round to a successful close will continue. In this environment, Japan's political leadership must reconcile its desire to be a global leader with the fallout from domestic economic policy initiatives that the international community finds protectionist. Put simply, Japan will have difficulty gaining credibility as a constructive player in international forums (including the G-20, WTO, and APEC) until the Government of Japan levels the playing field between JPB / JPI and the private sector and remedies the WTO inconsistencies in the current postal regime and the postal legislation.

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