

**"Reforming Government-Backed Financial Institutions:
the battle for postal savings reform in Japan"**

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Prepared for the Oct. 21, 2004 meeting of the Penn Comparative Politics Workshop
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Acknowledgements

Parts of this paper draw on a collaborative project underway with A. Maria Toyoda in which we investigate the impact of postal savings systems reform paths on the "deepening" or development of national financial sectors across a broad range of countries. My sincere thanks goes to Maria for many helpful conversations; and to the International Center for the Study of East Asian Development (ICSEAD) in Kitakyushu, Japan, for its generous financial support of that project. Thanks also goes to Harukata Takenaka, with whom Toyoda and I collaborated on another related project, and to the Shibusawa Memorial Foundation (Tokyo, Japan) for its generous financial support of that project.

Introduction

Numerous countries across the globe face significant challenges today in competently regulating, supervising and reforming government-backed financial institutions in line with a changing business environment. In 2003 and 2004, accounting irregularities surrounding government-sponsored mortgage finance companies Fannie Mae and Freddie Mac grabbed the headlines in the U.S., while in Japan, a political battle unfolded surrounding Prime Minister Junichiro Koizumi's attempts to privatize that country's government-backed postal savings and insurance systems.

Government-backed or government-owned financial institutions are typically established when private sector entities are either unable or unwilling to provide services deemed important by the government. Central to the success of such entities at the time of their creation is typically the preferential regulatory treatment they receive. Implicit or explicit government guarantees enable the issuance of debt at below market costs and, in the case of postal savings institutions, serve to maintain depositor confidence even in the face of volatility elsewhere in the financial sector. Preferential treatment early on also typically includes tax-exempt status, exemption from requirements to pay deposit insurance premiums or payments to other financial industry safety nets, and disclosure and accounting requirements less strict than those imposed on private sector firms.

Such operational parameters present regulators with special challenges in ensuring the accountability and efficiency of government-backed financial institutions. These challenges, present from the beginning, may be compounded as circumstances change and the rationale for the creation of these institutions expires or evolves. Once a nation's private banking sector becomes well developed and the nation attains industrialized status, the need for government-backed savings and banking institutions declines. At such times when efficiency arguments would suggest that reform is needed, these institutions often continue to operate because interests that become entrenched around these institutions resist change and the process of dismantling or reforming these institutions is fraught with political conflict. The capacity of governments to overcome the problem of entrenched interests and privatize, dismantle or reform institutions such as postal savings systems and development banks in ways that force these institutions to compete on equal footing with private sector firms varies significantly. And, the consequences of this variation in government capacity seem to be significant. Delay in adjusting institutions in light of new needs may negatively affect further attempts to develop a country's financial sector, impede the profitability of private sector financial firms and eventually lead to the socialization of losses through taxpayer-funded assistance or bailout.¹

This paper examines the political dynamics surrounding the reform of a particular type of government-backed financial institution: postal savings/banking institutions. It does as part of a broader objective of better understanding the role of politics in the operation of financial systems in different countries. How can these systems and the reform paths respective governments have chosen for their postal savings/banking institutions be understood with reference to politics? The widespread use of postal savings/banking institutions in countries around the globe makes the study of their political dynamics and reform paths amenable to comparative analysis.² In the

¹ Barth et al (1999) provide evidence that government ownership of banks is associated with lower levels of financial development, while Caprio and Peria (2000) show that the government ownership of banks is associated with higher likelihoods of banking crises.

² The US stands out as an anomaly here; although a postal savings system did exist briefly in the US, this system was dismantled in the 1960s. See Carpenter (2001) for an excellent analysis of

sections that follow, I focus on the case of Japanese postal savings reform but try to place the Japanese case in cross-national context. I also try to place the current political battle over postal savings reform in Japan-- playing out at this very moment under the Koizumi administration-- , in the context of past developments in Japan related to postal savings reform. By engaging in this diachronic analysis, I seek to highlight ways in which the nature of the political battle over postal savings reform has changed over the years.

The paper proceeds as follows. Section 1 provides an overview of the general role played by postal savings/banking institutions and the patterns of reform observed across countries. Upon this backdrop, section 2 then underscores particular puzzles presented by the Japanese case of postal savings reform—most notably, the long delay before significant reforms occupy an important place on the political agenda. Section 3 highlights why conventional explanations prove unsatisfying and presents alternative hypotheses related to the observed outcomes. Section 4 engages in a diachronic analysis of the reform story. Section 5 underscores the consequences of delayed reform by examining new problems faced by the government in carrying out major reforms, now that political will to reform is in place. Finally, section 6 ends with some closing comments.

1. Postal savings institutions and paths to their reform: an overview

Postal savings/banking systems have received little attention in the academic literature and are even excluded from many cross-national studies on state-owned banks.³ Yet, they are in many cases the largest banks operating in a given country, when measured in terms of asset size. Moreover, the special characteristics of postal savings institutions—most notably their extensive nation-wide networks that penetrate into rural as well as urban areas—make them particularly susceptible to political entanglement and political influence.

Postal savings institutions have long been used in developing and emerging market countries to help provide financial services to all segments of the population at times when private sector financial services are underdeveloped, to mobilize savings for development objectives such as the creation of national infrastructure (such as electric power, railroads, and highways) under conditions of scarce capital, and to finance public debt. In the early stages of financial development, postal banking, or other state-owned banks, can therefore be complementary rather than competing, filling niches that private banks are unwilling or unable to.

A typology of reform paths

Scher (2001) categorizes postal systems into three types of governance structures: the "traditional", "corporatized" and "privatized" models. While helpful, this typology needs to be broken down further to capture the nuances and implications of reform paths. Although public ownership remains the norm in the Asia-Pacific, for example, the forms of government management and structure of postal savings services varies significantly across the region. A more specific categorization is constructed in table 1. This typology draws on Scher (2001), as well as on "Privatising Post" (2000) (a report produced by Union Network International (UNI), a body representing the world's postal workers), and news reports.

how the rise and fall of the postal savings system fit into the history of American executive agencies.

³ Dinc (2004), for example, fails to classify Japan's postal savings system as a government-owned bank.

Table 1: Types of postal savings/banking governance structures

	Traditional model		Corporatized model		Privatized model
	Government ministry	Separate gov't administration	Public corporation	Special corporation	
Rationale	Development objectives-- provision of financial services undersupplied by the private sector; mobilization of capital	Need to rationalize costs and improve service quality	Need to rationalize costs and improve service quality	Need to rationalize costs and improve service quality	Elimination of competitive advantage vis-à-vis private sector financial institutions
Typical characteristics of governance structure	<ul style="list-style-type: none"> - Operates as department within the government - Operates within gov't-determined budget - All revenues returned to treasury 	<ul style="list-style-type: none"> - Remains part of the direct gov't administrative structure - Operates financially as a self-sufficient organization - Enjoys a degree of organizational autonomy 	<ul style="list-style-type: none"> - Gov't-owned corporation - Significant level of autonomy - Separate financial status, with operations and mgmt dependent on the profitability of services - Commercial imperatives balanced by specific community service obligations 	<ul style="list-style-type: none"> - Transfer of government assets and service responsibilities to corporate body operating under domestic company law (company may be fully or partially gov't owned) - Mgmt obliged to make profits for shareholders while maintaining community service obligations 	<ul style="list-style-type: none"> - Role of state limited to that of regulator
Examples	<ul style="list-style-type: none"> - Sri Lanka⁴ - India - [Japan until April 2003] 	<ul style="list-style-type: none"> - Japan (since April 2003)⁵ - Korea - Taiwan⁶ 	<ul style="list-style-type: none"> - Australia - Canada - Thailand 	<ul style="list-style-type: none"> - New Zealand - Malaysia - Indonesia - Great Britain 	<ul style="list-style-type: none"> - Netherlands

⁴ Categorization is as of 1998; the system was being overhauled in this year with the aid of the World Bank. World Bank, *Sri Lanka Postal Sector Reform Project*, 9 October 1998. Updated information has not yet been obtained.

⁵ The establishment of Japan Post in 2003 meant a shift towards the corporatization model; yet, many of the reforms typically seen accompanying corporatization elsewhere are absent in Japan.

		- Hong Kong ⁷		- Germany -Philippines	
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The typology in table 1 provides evidence that the *privatization* of postal savings is not the only avenue of reform; postal savings systems may be rationalized without privatization.⁸ Postal savings banks also need not be privatized to avoid contributing to overbanking problems. Arguably the most successful example of a reformed postal bank is that of Deutsche Post. Reformed in the latter 1990s, Deutsche Post has aggressively utilized its commercial freedoms to transform itself into a multinational company, engaging in major acquisitions and joint venture operations around the globe. The Deutsche Postbank is one of Europe's largest retail banks and by far the largest postal bank in Europe.

Many countries in Asia rank particularly high on global rankings of countries with widespread usage of government-backed financial institutions—and of postal savings systems, in particular (as measured in numbers of accounts per capita). Yet, it is not the case that national postal banking systems always contribute to overbanking problems. South Korea is a prime example. In Korea, postal savings does not enjoy the types of comparative regulatory advantages relative to private sector firms that are enjoyed by the Japanese postal savings system.

Drivers of reform

What factors have led governments to pursue reforms that move them from the traditional model of postal governance to one of the other more market-oriented categories? Reform pressures have varied from country to country but generally come about either as a result of demands from within a country—typically from taxpayers—or as a result of demands by an external entity with some leverage vis-à-vis a particular country's government.

In the first case, governments may come under pressure to withdraw subsidies from postal savings systems because these systems are perceived as inefficient and no longer providing the public goods they were established to provide. If taxpayers feel that publicly supported entities have become bloated and their costs of operation fail to exceed the public benefit provided, then elected officials may face pressures to carry out reform. In a 1999 study, the OECD suggests that a desire to improve profitability, service quality, productivity and efficiency is behind the global trend toward corporatization, wherein most countries transform postal operations from government departments into public corporations or plan such changes in the future.⁹

A second impetus for postal savings reforms may come from outside the country. External pressure for reform may aid policymakers in overcoming entrenched interests related to an

⁶ While the government proposed corporatization and the separation of postal savings service from mail services, a campaign by the postal workers union led the government to drop structural separation as a reform objective. *Privatising Post* (2000), p. 40.

⁷ Operates as an external government agency, wherein postal employees retain their civil service status but private sector management techniques and approaches are integrated into the postal services, leading to the contracting out or privatization of services.

⁸ Importantly, the reform or privatization of postal savings must not be confused with the argument for or against privatizing basic postal services such as mail delivery. Postal savings/banking institutions have been rationalized and reformed-- or even privatized-- in many countries while basic postal services such as mail distribution have remained government-run.

⁹ OECD, *Promoting Competition in Postal Services*, Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy, (Paris, OECD, 1999), p. 7.

inefficient postal system. In the case of developing countries, external pressures typically emanate from international organizations such as the World Bank. While the World Bank is a major proponent of postal savings systems and has aided in their establishment in many developing countries, the Bank at the same time has emphasized commercialization and profitability of postal services. Accordingly, the Bank today aids developing countries in eliminating government subsidies and developing postal services into a commercially viable entity.¹⁰

This focus by the World Bank has been cited as a key reason why governments in the Asia Pacific have begun to adopt a more commercialized approach in recent years.¹¹ In the Philippines today, the World Bank's position influences the nature of political debate surrounding reform of postal saving. And, in Sri Lanka, where operations of the postal savings bank have deteriorated over the years, postal financial services are also being overhauled with the aid of the World Bank. The Sri Lankan government aims to rationalize operations and restore the capacity of its postal bank to use postal savings as a vehicle to increase savings mobilization and provide a convenient means for funds transfer—the role for which it was originally established. It intends to do this by having the Post's financial services enter into a partnership with an experienced (and presumably private sector) financial institution. Doing so is expected to attract significant investments in financial services infrastructure and supplement the lack of institutional capacity within the Post Office.¹²

In the case of developed countries, reform may be aided by the need to abide by supranational entities such as the European Commission in Europe. Many policy conditions have been attached to membership in the European Union. Among these is the requirement of structural separation of postal operations, and the operation of postal banks on equal footing with private sector banks. European Union Postal Directives emerged prominently in the latter 1990s, with most coming into force in 1999. Although countries within the European Union have chosen to adopt different types of governance structures, all share the characteristic of operating without the privileges seen under the "traditional" model of postal governance—that is, they must respond to market forces.

2. The Japanese puzzle

The Japanese case of postal savings reform is of particular interest because it represents a case of extreme delay in the reform of a government-backed financial institution and this delay has had severe repercussions. Efficiency arguments for maintaining Japan's postal savings system have been weak since the mid-1970s. By that time, Japan's banking and insurance sectors were large and well developed, savings had come to exceed demand for capital, and the nation was highly industrialized. Yet, these government-backed financial institutions continued to enjoy highly preferential treatment relative to private sector entities. Only under the Hashimoto administration (1996-98) did reforms commence. And, even then, reform remained restricted to changes in the way in which government-affiliated financial institution procured funds. With the ascension of Junichiro Koizumi to the prime ministership in 2001, more comprehensive reforms of postal savings first emerged as an issue seriously pursued in the political arena.

¹⁰ The World Bank, *Postal Sector Reform - Overview*, The World Bank, Private Sector Development, <http://www.worldbank.org/html/fpd/privatesector/postal.htm>.

¹¹ "Privatising Post" (2000), p.46.

¹² World Bank, *Sri Lanka Postal Sector Reform Project*, 9 October 1998

Today, Japanese post offices sell the same products as commercial banks, while continuing to enjoy exemption from the payment of taxes and the payment of deposit insurance premiums. The government's lack of inspection of risk management operations by government-backed financial institutions until recently also eased the imperative for holding levels of loan loss reserves similar to those held by private financial institutions or engage in other costly means of counteracting lending risk. In short, the postal savings system continues to enjoy significantly lower operating costs than the private sector. This situation persists even as the government pressures private banks to regain profitability so as to repay public funds received in 1998 and 1999, and as the government recognizes the severity of the nation's overbanking¹³ problem. These outcomes seem to represent an extreme form of inertia in reforming a government-backed financial institution.

The delayed and incomplete nature of reform of Japan's postal savings system over the postwar period has led to a number of ironic outcomes. Although the second largest economy in the world and one of the world's most advanced industrial nations, Japan ranks number one among both developing and developed countries in the widespread usage of its postal savings system, as measured by number of accounts per capita.¹⁴ At the same time, this very postal savings system exacerbates Japan's serious over-banking problem and thereby contributes to the delay in getting the private sector financial system back on track.

In these ways, a first puzzle is why there has been so much inertia in Japan. A second puzzle, however, has to do with the sudden shift under the Koizumi administration to carry out full-blown privatization. As noted in the earlier typology, governments rarely pursue complete privatization. Moreover, privatization is particularly problematic as a reform strategy for Japan today because of the current state of the private banking sector and the role that the postal savings systems has played as a major purchaser of Japanese government bonds (section 5 discusses these issues in depth). Yet, Japan's prime minister is clearly fixated on privatization and holds it up as the mantle of his administration. Why the attempt to shift suddenly from inaction to the most extreme form of reform?

Motivations for solving this puzzle

By uncovering the political dynamics surrounding the management of the postal savings system in Japan, the next section hopes to bring us a step closer toward understanding what changes serve as prerequisites to Japan's financial system recovery today. Why does the government inject taxpayer money into banks in an attempt to help them recover profitability while at the same time support postal savings and other government-backed financial institutions, which heighten competitive pressures on these same banks? Such questions need to be answered if we are to specify the political changes needed before Japan can get its financial system back on track.

A better understanding of the political determinants of reform and the implications of delayed reform is also relevant for those seeking further liberalization of the Japanese financial services market. Japan's postal savings system (effectively the largest bank in the world in terms of asset size), along with the postal life insurance system (with assets three times those of the largest private insurer in Japan), have been the focus of harsh criticism by US government officials and financial industry representatives in the context of bilateral negotiations over financial sector liberalization since the 1990s. Technically, the continued government backing of postal savings

¹³ Overbanking refers to a situation in which too many banks compete for a limited amount of business, leading the profits of all banks to suffer.

¹⁴ Scher (2001), Table 1 "Postal savings data from DESA survey."

also violates Japan's commitments to the World Trade Organization (WTO). While it is widely recognized that Japanese officials have made significant progress in opening the financial sector to new domestic and foreign actors alike, the unfair competitive advantage enjoyed by these government-backed financial institutions represents a lingering impediment to the full-fledged liberalization of the Japanese financial services sector.

It is also hoped that the analysis that follows also proves relevant to international aid organizations such as the World Bank, Asian Development Bank, and International Monetary Fund. These international institutions continue to encourage the establishment of postal savings systems in developing countries across the globe. By the completion of this study, it is hoped that the Japanese case will provide important insights into how the design of such systems in other countries might be fine-tuned so that their institutional rigidity does not pose a challenge to sustained economic growth or impede further financial sector development down the road.

3. Conventional wisdom about the political dynamics of postal savings and some new hypotheses

Existing works by political scientists on Japan's postal savings system are sparse but those that do exist place primary emphasis on the political clout of the Japan Postmasters Association in explaining the failure to reform postal savings in Japan.¹⁵ This explanation alone proves unsatisfying, however. Political interests became similarly entrenched in local areas in numerous other countries across the globe as a result of the introduction of postal savings systems. And, many of these other systems have been reformed nonetheless. Moreover, meaningful postal savings reforms need not equate with all-out privatization of the system, as evidenced by table 1 and the successful reform carried out in the postal banking systems of countries such as France. Thus, "reform" need not equate with the loss of jobs for Japanese Postmasters or elimination of their political "rents."

Hypotheses

The inadequacy of existing explanations for inertia in postal savings reforms leads me to explore alternative explanations that address the political factors influencing both the supply of and demand for Japan's government-backed financial institutions. On the supply side, Japanese citizens have proven more willing to entrust their funds to postal savings than to private banks and clearly have felt more endeared to these institutions than to the banks. I hypothesize that the reason for this is a combination of two factors: the nature of *private sector* financial regulation in Japan (often referred to as the "convoy approach" to regulation) which led private banks to focus little on retail banking; and, the relatively high degree of competence observed in the administration of the postal system in Japan over the postwar period by the Ministry of Posts and Telecommunications (MPT), relative to performance of the MPT's counterpart government agencies elsewhere in the world.¹⁶

Japan and Taiwan stand out as countries where external pressures for reform have proven less salient and where domestic efficiency arguments have not proven strong enough to override the power of unions or other entrenched political interests. As a result, reforms have been slow and less substantial in these two countries. I turn now to consider some factors acting in favor of the *supply* of postal savings institutions and against the emergence domestically of prominent arguments touting the need to reform postal savings out of efficiency concerns.

¹⁵ See Maclachlan (2004), for example.

¹⁶ As Carpenter (2001) notes in his analysis of the short-lived US postal savings system, the perceived incompetence of government agencies relative to the private sector was a major reason for the system's downfall.

Japanese citizens have historically proven more willing to entrust their funds to postal savings than to private banks and clearly have felt emotionally “closer” to these institutions than to the banks for at least two reasons: the convoy approach to private bank regulation which led banks to focus little on retail banking; and, the degree of competent bureaucratic administration of postal savings over many years.

The "convoy" approach (*goso sendan hoshiki*) to regulation in Japan meant that no banks were permitted to move ahead in the industry in such a way that would endanger the viability of any other bank. Japanese banks never focused on retail banking operations and, in fact, the post offices did a much better job in meeting the needs of financial consumers. The warmer feelings individual financial consumers had for postal savings institutions was reflected in the often-spoken phrase, “post offices are kind to the people” (*Yubinkyoku wa kokumin ni shinsetsu*).¹⁷ If the debate over rationalizing or privatizing postal savings could be depicted as one pitting efficient banks versus inefficient postal savings institutions, the public would likely have shown more understanding to the needs of reform. But, the banks were not seen as efficient (and, such measurements as return on equity (ROE) suggest these perceptions were correct). In the eyes of financial consumers, banks charged lower rates of interest on deposits and higher service charges than the post offices. Bankers were also perceived as proud (*ibatte iru*), overpaid, and as placing distance between themselves and the common person, "hiding away in tall buildings."¹⁸

Even today, the difference in attention to retail financial services between the private banks and post offices is stark, although the gap is rapidly narrowing. For example, in contrast to the private bank ATMs, the post office ATMs charged no service charges for early morning or late night usage. From January 2000, postal ATMs extended their hours of service fee-excluded usage times to span from 7am to 11pm. In contrast, Japan's large city banks were only expanding their similar usage- without-service-charge period in 2003 to go until 9pm. Thus, the nature of private sector banking regulation had an important impact on the provision of retail financial services by private banks. Specifically, the nature of banking regulation helped place distance between individual financial consumers and private banks. Importantly, this underdevelopment of Japan's retail banking sector would also eliminate one potential avenue for reform of postal savings. A survey of postal savings/banking reforms across the globe reveals that, with the process of liberalization and privatization, private financial institutions with alternative retail strategies often seek into agreements with postal agencies or even purchase postal institutions. Japan's banks had little in terms of strategies to offer, however, and were instead in the position of needing to learn from postal operations.

A second component of the explanation for why domestic arguments grounded in the logic of economic efficiency have not figured prominently in Japan may have to do with the relative competence of Japan's bureaucracy in administering the postal savings system. In most countries, the move to privatize comes from a realization of inefficiencies resulting from public ownership. The MPT's relatively efficient operations in Japan—a byproduct of having a capable bureaucracy in place over much of the postwar period and the stability and continuity in network relationships—meant that such demands were less forthcoming in Japan.

¹⁷ Amyx interview with long-time Japan Federation of Bankers Association official, Yoshida Satoru, 2003.

¹⁸ Author interview with veteran Zenginkyo official, Satoru Yoshida, 2003.

On the demand side of the equation, the literature on the political clout surrounding the users of postal savings is underdeveloped. Due to space limitations, this paper will not address this aspect in depth but in future work I wish to investigate the networks linking the users of postal savings—government-backed institutions such as the Development Bank of Japan-- to Diet members and to industry actors, particularly those in construction and other areas of public works. I suspect that the political dynamics here have been more directly salient in impeding reform than have been the political clout of postmasters largely because interviews with rural postmasters has suggested that their political clout has been on the decline for some time.

The reform story told in the next section elaborates more fully on the points made above.

4. The evolution of forces in favor of reform

Prior to the bursting of Japan's speculative bubble (through early 1990s)

Japan's postal savings system was established in 1874 but the system of postwar postal savings can be traced to the establishment in 1947 of the Postal Savings Law, amid the move to rebuild Japan after the Pacific War. Throughout the era of rapid economic growth in Japan, postal savings deposits were funneled into other government-backed institutions such as the Japan Development Bank, which in turn invested in the nation's economic infrastructure. During this period, the private banking sector was highly regulated, with government-determined interest rates, and was highly compartmentalized.

In 1969, the first public complaints arose out of the private banking sector with regard to unfair competition from postal savings. In this year (by which time rapid economic growth had made Japan a major success story), the banking industry association *Zenginkyo* argued within a government deliberation council (*shingikai*) that postal savings should supplement / complement banking operations, thereby inferring that it was competing head-on with the banks. Such calls fell on deaf ears. The issue was raised again, most notably in 1981, but the banks failed to generate much support for their position. In 1981, in response to growing criticism from the banking industry, the Ministry of Posts and Telecommunication (MPT) issued a statement to the effect that postal savings continued to meet the needs of individual savers in a way that banks did not. MPT also noted that the exclusive focus by the postal savings system on individuals distinguished its business from that of the private banks and concluded that it was only natural for the government to continue to provide services where the private sector remained underdeveloped (business focus exclusively on individuals).¹⁹ As a result of the protest from the banking industry, however, the government did respond by allowing banks to diversify the offering of their financial products and to introduce fixed term savings instruments. Nevertheless, postal savings retained its comparative price advantage, offering higher interest rates on deposits. It is important to note that until the 1990s, Japanese private banks operated in what amounted to a cartel, and the government provided an implicit guarantee against failure.²⁰

When MPT and the Ministry of Finance finally decided to liberalize postal savings interest rates, liberalization was done incrementally, beginning in 1985, and was only completed at the end of 1992. By 1992, banks were on equal footing in terms of the financial products they could offer but by this time, private banks were also dealing with massive amounts of nonperforming loans in

¹⁹ Yubin Chokin in Kan suru Chosa Kenkyukai (Study Group on Postal Savings), Ministry of Posts and Telecommunications, March 1981, cited in Ishii (2000), p. 176.

²⁰ See Amyx (2004) for a detailed analysis of the way in which this worked, including an examination of the relational ties linking the Ministry of Finance to banks.

the aftermath of the bubble's collapse²¹ and instability in the banking sector contributed to citizens placing greater confidence in the postal savings system than in banks. According to a public opinion poll conducted by the *Tokyo Shimbun* of the Tokyo Metropolitan area at the end of 1995, citizens felt most anxious about the stability of Japan's credit cooperatives.²² This was understandable since news was dominated by coverage of two failed Tokyo credit cooperatives. One in eight citizens also expressed anxiety at this time about the stability of the city banks.²³ In the period 1994-1999, the number of post offices grew by 297 to number 24,690 and amounts held in postal savings increased accordingly.²⁴

Another important development in the 1990s that accompanied financial sector instability was the emergence of scandals in the banking sector. A number of individuals both from the private sector and the Finance Ministry were arrested for the giving or receipt of bribes and for excessive wining and dining. With the banking system enshrouded in scandal, appeals in the 1990s by the Bankers' Federation for more transparency in the management of postal savings fell on deaf ears. In December 1999, Zenginkyo put together a pamphlet titled "Yubin chokin ni kan suru Watakushidomo no kangaekata" (Our private thoughts on postal savings). This national appeal by bankers called for clarification of the purposes or aims of the postal savings system, a freeze on and reexamination of the business areas postal savings was permitted to engage in, a shrinking of its special privileges associated with its special relationship to the government, clarification that its operations were self-sufficient, inspections and supervision by the nation's financial regulator (the FSA at this time), widening of disclosure requirements, and the separation and dismantlement of cross-subsidization of operations.²⁵

Only under the Hashimoto administration (1996-98) did postal reforms rise to a prominent place on the political agenda. In November 1996, an administrative reform council chaired by the prime minister started deliberating the reorganization and consolidation of government ministries and agencies, a process considered necessary for dealing more flexibly and skillfully with complex administrative issues. Among those agencies that would be reorganized was the Ministry of Posts and Telecommunications, which had long overseen Japan's postal services.

The Reform Council released an interim report in September 1997 which recommended that postal life insurance be privatized immediately, postal savings be prepared for privatization, and mail delivery operations remain under the purvey of a government institution. Postal unions strongly opposed these recommendations, however, arguing that the separation of the three postal services would mean that mail delivery could not longer be maintained at a uniform rate across the country (since delivery operations were subsidized by postal savings operations). The unions waged a successful campaign against the interim report proposals, hiring a private consulting firm to conduct public opinion polls showing that the public opposed the separation of services, staging demonstrations and using advertisements and direct mail tactics to garner supporters.²⁶ While the Bankers' Federation argued in this period for more transparency in the management of

²¹ Japan experienced a massive speculative asset bubble in its economy in the latter half of the 1980s. The bubble burst in 1990-91.

²² Ishii (2000), p. 179.

²³ Poll results cited in Ishii (2000), p.172.

²⁴ Ishii (2000), p.171.

²⁵ Ishii (2000), p.181-182.

²⁶ "Privatising Post" (2000), p.88.

postal savings, such appeals fell on deaf ears since the banking system itself was enshrouded in scandal and plagued by accusations of opaque management practices.²⁷ According to a 1997 poll, 50-60 percent of the public desired that the postal savings system be maintained unaltered.²⁸

In the final report of the Administrative Reform Council, the decision was made to retain postal savings but to place postal services under the jurisdiction of a newly formed independent but government-backed agency. After 5 years of operation, this agency was to be transformed into a new government-run public corporation (privatization was not mentioned). Most importantly, postal savings funds (i.e., account deposits) would no longer be re-deposited with the Ministry of Finance's Trust Bureau but would instead be invested autonomously by the Postal Savings Services, with the caveat that they would continue to be invested in safe, secure long-term instruments. A Basic Law on Government Agency Reform, which incorporated the Reform Council's recommendations was presented to the Japanese Diet as a Bill in February 1998 and was subsequently passed in June of the same year.

In December 1999, as the banking sector appeared to stage a bit of a recovery, the Bankers' Association put together a pamphlet that represented its first attempt at a national appeal for reform in the postal savings system. In the pamphlet, titled "Our private thoughts on postal savings" (*Yubin chokin ni kan suru Watakushidomo no kangaekata*), the industry representative sought clarification of the purposes or aims of the postal savings system, a freeze on and reexamination of the business areas postal savings was permitted to engage in, a shrinking of the special privileges associated with the postal savings system's special relationship to the government, clarification that postal savings operations were self-sufficient, inspections of postal savings institutions and their supervision by the nation's financial regulator (the FSA at this time), a widening of disclosure requirements for postal savings institutions, and the separation and dismantlement of the cross-subsidization of operations.²⁹ Little government response to these appeals was observed, however.

Prime Minister Koizumi comes to power in April 2001

As planned in January 2001 the Ministry of Public Management, Home Affairs, Posts and Telecommunications was established as part of the reorganization of the central government administrative organs and the new Postal Service Agency placed within this new ministry. Soon thereafter, another event that would have a significant effect on the three postal related services took place within the LDP. In March 2001, then prime minister Yoshiro Mori, resigned due to increasing unpopularity and amid a plunge in the nation's stock market that sent it to new post-bubble all-time lows. In April, the LDP held an election to nominate the succeeding president. Junichiro Koizumi, a former minister of welfare and minister of posts and telecommunications obtained a landslide victory in the election, pledging to privatize the three postal related services.

²⁷ The more positive perceptions of postal savings held by individual financial consumers was still evident as late as 2000, by the results of a *Nikkei* survey in which depositors were asked their opinions about the safety, convenience, and information disclosure they associated with private sector banks compared to postal savings. While the replies in favor of postal savings for safety and convenience come as no surprise, given the instability of banks in the 1990s, the perception that postal savings institutions practice greater information disclosure was highly ironic, given the incredible opacity that surrounds the operations of postal savings.

²⁸ Mainichi Shimbun: 40 percent; Asahi Shimbun: 54 percent; Nikkei Shimbun: 58 percent; Jiji Tsushin: 64 percent. Cited in Ishii (2000), p. 187.

²⁹ Ishii (2000), p.181-182.

More specifically, he pledged to consider the privatization of the three postal services once the new public corporation was established in 2003. Immediately after becoming Prime Minister, Koizumi appointed a private advisory council to discuss the future of the three postal related services and the privatization of these services was put on the political agenda for consideration again. In the explanation of what this group would do, “privatization” (*min'eika*) was used for the first time in an official government document. Few in the bureaucracy or banking industry believed that *privatizing* the postal savings system was a realistic possibility until Koizumi's emergence as the prime minister.³⁰ Koizumi not only pledged to privatize the three postal services upon becoming the president of the LDP; he also made a concerted effort in the policymaking process to bypass the customary examination of related bills by the LDP's Policy Affairs Research Council (PARC). This has greatly angered the Hashimoto faction (his longtime political rival and staunch supporter of the postal savings system) and it remains to be seen whether his privatization legislation will actually pass in the Diet..

What has motivated Koizumi's persistent support for privatization? Koizumi has been an advocate for radical changes in the three postal related services for over 20 years. His argument for privatization today often makes references to inefficiencies in government institutions. Yet, it is difficult to discern the primary motives he harbors for privatization, given that major changes were carried out in 2001 that altered the mechanism for using postal savings funds. This occurred as part of the reforms of Japan's Fiscal Investment and Loan Program (FILP)³¹. The FILP was akin to a second budget—and one that lacked transparency. Money was funneled from postal savings deposits, postal insurance income, and government pension funds into a fund managed by the Finance Ministry, which in turn, loaned the money to government-backed institutions (such as the Japan Development Bank and the Japan Bank for International Cooperation). As criticism of the inefficiencies of the latter entities arose, the argument emerged that the way to hold these entities more accountable was to cut off their guaranteed source of funding and have these institutions raise funds on their own, through the issuance of bonds.

Some point to the fact that Koizumi's political strategy has long been one in which he suggests dramatic measures and conveys ideas to the public in an easy to understand manner. As one bureaucrat notes, 'reform' (*kaikaku*) is an everyday word in the political world and one that few take seriously. When a politician declares an objective of 'reform,' it is usually a very vague notion. Using the term 'privatization' grabs peoples' attention, however, and the meaning is much clearer than 'reform.'³²

Koizumi's privatization drive comes upon the background of the weakening political clout of postmasters. Existing works describe the way in which postmasters are closely woven into the social and economic fabric of the local community helped enable this group to act as effective vote-gatherers (see Maclachlan 2004, for example). Even as early as 1993, however, the postmasters association clearly sensed that the pressures on them would only increase in the future. A booklet published at that time by the association reviews the history of the commissioned post office system and the battles it has fought to the present day, expressing anxiety about the future of the postal business: "On the surface, there is the sense that things are stable but inside (*naiyotekini*) there are many problems... " The foreword then goes on to express the hope that the booklet will enable each commissioned postmaster to come to a unified

³⁰ Author interviews with MOF and Japan Bankers' Association officials, 2003.

³¹ For a detailed analysis of this system, see Calder (1989; 1990; and 1993) and Toyoda (1998).

³² Author interview with central government bureaucrat, Feb. 2004.

consciousness about the organization's history, role and future visions which will, in turn, lead to united actions (with these actions implied to be the staunch opposition to major system reforms).³³

The launch of Japan Post in April 2004 as an independent administrative institution (IAI) affiliated with the Ministry of Public Management and the preparations leading up to its launch have also served to weaken the potential clout of postmasters. Since the establishment of Japan Post, postal savings and postal insurance have come under the jurisdiction of the Financial Services Agency (FSA), which now carries out regular inspections.³⁴ This means that even the commissioned post offices are subject to inspections. Moreover, rural postmasters report that the management of finances has become much stricter. A number of special postmasters in one village in rural Gifu Prefecture noted, for example, that prior to the past few years, numerous customers had more than the legal limit of 10 million yen deposited in their respective accounts and the excess was literally ignored. Over the past couple of years, however, the management of account transactions has all become computerized, enabling the immediate detection of such over-deposit incidents and special postmasters have been strictly ordered not to accept deposit amounts over the legal limit. "I feel badly," one commissioned postmaster said, "but I must make the rounds in the village and return excess deposit amounts to customers these days."³⁵

Other factors such as the depopulation of rural areas and the greater accessibility to many different sources of information also work as factors decreasing the capabilities for political mobilization of the special postmasters association. One rural postmaster also related: "These days, young people would rather drive to a bank in a nearby town and do their transactions more anonymously than keep their money in this post office. Doing the latter means that I have personal knowledge of their financial situation and this is annoying (*iya*) to them."³⁶ A 91 year old retired commissioned postmaster also notes that when he served as the postmaster decades ago, people in the village often looked to him for guidance on who to vote for. "But, that was in the days when there weren't many sources of information about candidates and politics and things," he noted. "These days, people have many different sources of information on which to base their voting decision."³⁷

A final reason for the decline of political strength of the special postmasters association lies in experiences from the 2001 elections. In that year, 16 individuals—including elite postal bureaucrats and postmaster association members-- were arrested for violating the Public Offices Election Law that bans public servants such as postmasters from campaigning for a specific candidate. LDP representative Kenji Koso, whom the special commissioned postmasters association backed, was forced to resign from the Diet to accept responsibility for these breaches of the law. This incident is clearly in the minds of current postmasters and means that as a group,

³³ Tokutei Yubinkyokuchō (1993).

³⁴ Financial *supervision*, however, remains with the Ministry of Finance, as is the case with all government-backed financial institutions. The FSA reports its inspection results both to the MOF and to the Ministry of Public Management

³⁵ Author interviews with commissioned postmasters (current and retired) in rural Gifu-ken, May 2004.

³⁶ Author interviews as noted above.

³⁷ Author interviews as noted above.

they are maintaining a noticeably lower profile this time around to avoid the recurrence of similar problems.³⁸

5. Problems with Koizumi's privatization plan

The strength of the argument for significant reform of the Japanese postal savings system is undeniable. Today it is seen as a symbol of 'bloated public finance.' In 2004, articles focused on inefficiency in postal savings operations were cited repeatedly in Japan's Wall Street Journal equivalent, *Nihon Keizai Shimbun*.³⁹ For example, in April, it was revealed after an inspection by tax authorities that Japan Post and its predecessor had failed to collect 15.16 billion in withholding taxes on postal savings interest from FY2001-2003 because of erroneous application of tax exemption extended to the elderly and disabled to noneligible customers. Moreover, as a public entity, Japan Post is not required to pay taxes at present. Once privatized, however, Japan Post will need to pay 533 billion yen a year in national and local taxes, according to its own internal estimate. The projected tax payment is expected to contribute to the government's fiscal reform efforts. Japan Post also estimates that, upon privatization, it would likely need to pay 200 billion yen in premiums to the government-backed Deposit Insurance Corporation (DIC). Clearly, this would be a boon to the finances of the DIC, which required an injection of public funds in the late 1990s to deal with the nonperforming loan problem in the banking system. Furthermore, while the Postal Savings Law stipulates that postal savings should be provided universally, a 2003 report by the Japan Bankers' Association shows that out of the 3,247 cities, towns and villages in Japan, only ten lacked any type of private financial institution in 2001.⁴⁰ The number of individuals left without any financial institution in their immediate locality if postal savings institutions disappear would total a mere 6769 nationwide (2747 households).

Nevertheless, the reform path of *privatization* is problematic. Since the announcement by the Koizumi administration that postal services would be privatized in April 2007, a committee under the umbrella of the Council for Economic and Fiscal Policy (CEFP) has convened to discuss privatization scenarios. Despite Koizumi's personal enthusiasm for privatization (he went so far as to do the calligraphy on the signboard for the Preparatory Office for Postal Privatization

³⁸ As a result, the postmasters' OB (alumni) group is the focus of political activities, as retired postmasters are no longer public servants. The sensitivity of the issue of political campaigning was clear to this writer in interviews with rural postmasters in Gifu-ken. Whenever questions were made to current postmasters about political activities, the reply was "well, there was the incident three years ago, so...." Author interviews as noted above. OB were much more willing to talk.

³⁹ Such articles were especially numerous in the May 26, 2004 issue. One article, for example, emphasized the massive size of postal savings assets but then noted the abysmal returns on capital, even in comparison to Japan's domestic mega-banks.

⁴⁰ Private financial institutions are defined here as city banks, regional banks, trust banks, long term credit banks, second tier regional banks, *shinyo kinko*, *shoko chukin*, *shinyo kumiai*, agricultural cooperatives (*nokyo*), fishing cooperatives (*ryukyo*), and *rodo kinko*. "Yubin Chokin Jigyo ni tsuite" (May 12, 2003), p.3. In the smallest villages that have a single private sector financial institution, this is almost always the financial arm of *nokyo*, which—like postal savings—has a ceiling on the permitted deposit amount of 10 million yen (Author 2004 interviews).

himself)⁴¹ the further discussion proceeds within the committee, the more evident it becomes that numerous impediments lie in the way of the actualization of Koizumi's privatization objectives. Importantly, these impediments differ significantly from the impediments to significant reform in previous decades and illustrate the fact that the timing and nature of reform path taken are of critical importance. It is worth noting that there are numerous reform paths for postal savings systems that have not involved privatization which countries across the globe have successfully pursued (see Appendix 2).

The condition of the private sector banking system

In most cases when inefficient services are privatized or liberalized, a major political issue surrounding the process is that exposure to the competitive pressures of the market poses the threat of decimation. Privatization of postal savings today would not have this effect.⁴² If we ask who would *lose* from privatization today, the answer is Japan's private sector regional banks and the Japanese government itself. Today, Japanese regional banks are not in need of additional deposits; nor are the larger city banks. If these financial institutions were forced to absorb the massive amounts of deposits now in the postal savings system, their already abysmal profit margins would suffer severely, due to the weak demand for loans.

Because of the special situation of virtually zero interest rates and stagnant demand for loans, private sector banks have little incentive to try to compete for the public's deposits. The banks' objectives in the areas of retail banking focus on trying to convince individuals to invest their money in new financial instruments but many customers remain reluctant to do so, perceiving such alternative investment means as risky. At a time when banks must rationalize operations, they are in some respects making themselves even less attractive to financial consumers by closing bank branches. At the same time, many of the banks that once opposed the existence of postal savings have become integrated into the postal savings system ATM network, as a means to expand their capacity to compete for retail business.⁴³ In this way, the industry's stance from previous eras of total opposition to the postal savings system is no longer as clear-cut.

One proposed solution is for post offices to sell products for banks. But, this proposal assumes that postal workers have financial skills. Many postal workers are not highly educated. And, in general, postal workers do not have many skills. Thus, some argue it is difficult to envision post offices switching into the role of intermediary, selling many different types of financial products for banks, while retaining their current work force. Representatives of foreign financial institutions argue, however, that this problem is not insurmountable. One could have regular 'financial services weeks' in rural areas where products are introduced and explained, internet connections could be subsidized so everyone was connected with a financial expert when

⁴¹ Kantei, "Prime Minister Delivers Address on the Launching of the Preparatory Office for Privatization of Postal Services" (April 26, 2004). The Preparatory Office was established in the Cabinet Secretariat on April 26, 2004,

⁴² It should be noted, however, that a successful long-term business model for a privatized postal bank is missing from current plans.

⁴³ Citicorp, a foreign bank, was the first to approach MPT to pursue the possibility of joining the postal savings system ATM network (the idea of doing so had been considered taboo among Japanese banks). Once Citicorp became integrated into this network (as the first private sector financial institution to do so), Japanese banks felt pressure to join as well, as not doing so left them at a comparative disadvantage. In effect, this led the banks to engage for the first time in cooperative relations with the postal savings system.

questions arose, and the range of products available at post offices could also be limited to a relatively simple selection.⁴⁴

The issue of Japanese government bonds (JGBs)

A second, and perhaps even important impediment to privatization relates to its potential impact on public finances. The postal savings and postal insurance systems today hold over 20% of the total balance of Japanese Government Bonds (JGBs).⁴⁵ If these entities are privatized, then the management of their investments becomes free from government control. Given the low return on JGBs, it is likely that rational actors would seek better investment opportunities and engage in widespread selling. The damage to the Japanese government bond market could be huge. This is of concern not only to the Finance Ministry, but also to the Bankers' Association, which fears that private banks might come under pressure to purchase more bonds in such a situation.

Ironically, however, exposure of the postal savings system to government debt is *growing* at a time when these agencies' freedom to invest in the market is also supposed to be growing. In FY 2004, the postal savings system is expected to absorb 19.7 trillion yen of Japanese government bonds (JGB) issues, compared with 9.9 trillion yen in FY 2003.⁴⁶ Even while the Finance Ministry scrambles to market JGBs to individual and other investors to limit the concentration of holdings (diversification limits the likelihood of a shock to the market arising from economic difficulties faced by institutional holders), the simple jump in the amount of government and government-guaranteed bonds limits the impact of such efforts. With an approximate doubling of Japanese government indebtedness over the past decade, the size of the JGB market now exceeds even that of the US Treasury market. This comes at a time when market actors have become increasingly reluctant to absorb more JGBs, given their negative experience in June 2003 when a sudden, sharp surge in yields left holders with substantial paper losses on their portfolios. Consequently, public institutions such as postal savings are more important than ever to the government in absorbing JGB issues.

6. Closing comments

This paper has sought to better understand why and how institutions created to serve the public good and provide services in critical *undersupply* at one point in time may eventually lead to the *oversupply* of these services, crowding out private financial firms and stifling further financial sector development, thereby undermining the sound functioning of the financial system and posing a challenge to sustained economic growth. The in-depth study of the evolution of three government-backed financial institutions in Japan not only provides an opportunity to shed light on the political factors affecting processes of institutional adaptation and change but also provides an avenue for understanding the political conditions under which private rather than public gains from the operation of government-backed financial institutions eventually may prevail.

As shown above, the political dynamics surrounding liberalization and reform of the postal savings system differ significantly today from political dynamics surrounding this issue in earlier periods. Whereas Japan's banking industry organization, *Zenginkyo*, once spoke for all banks

⁴⁴ Author interview with members of the American Chamber of Commerce in Japan Financial Services Committee, June 2004.

⁴⁵ Zaimusho Rizaikyoku, "Waga Kuni no Kokusai Kanri Seisaku" (April 8, 2003), p.19. All government-backed financial institutions together held 41.1% in 2003. By comparison, the equivalent figures for the U.S., Great Britain, Germany and France are 12.8%, 3.9%, 0%, and 15.7%.

⁴⁶ Oxford Analytica Daily Brief (Jan. 2004)

seeking the government's privatization of postal savings, today private Japanese regional banks stand strongly opposed to the privatization of postal savings. For banks, the spread between deposits and loans is a key profit source. If banks were to absorb the deposits in today's postal savings system without obtaining corresponding lending opportunities, they would be in dire financial straits. Today Japanese banks don't need more deposits; rather, they need more opportunities to lend or more promising alternative investment opportunities. As one of Japan's top banking analysts, Katsuhito Sasajima, notes, one could imagine a situation in which regional banks required capital injections from the government in order to survive the privatization of postal savings!⁴⁷ At the same time, we could imagine a situation in which the Bank of Japan is called upon to purchase large amounts of Japanese Government Bonds to ward off a disaster in the government bond market resulting from the privatization of postal savings and insurance.

The privatization of postal savings represents both a threat and an opportunity. How it plays out hereafter will have a major impact on the functioning of Japan's financial system. Given that Japanese postal savings is essentially the largest bank in the world, its reform path also has consequences to some extent for the international financial system.

⁴⁷ Author interview with Sasajima, June 2003.

While the causes of Japan's prolonged economic stagnation and elusive financial sector recovery are complex, it is widely acknowledged that the slow pace of reform in the nature of government-affiliated financial institutions has contributed to the nation's problems.

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