



## Where will Japan's postal funds end up? The money trail and the future of reform

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By Hara Manabu

*[Hara Manabu nicely sums up some of the misconceptions on postal privatization that lay behind LDP victory in the just-completed election. As Hara writes, many voters believe that the Koizumi plan will go a long way towards lifting the economy out of years of sluggish growth and mounting monumental debt. Yet most experts who actually know what's in the privatization plan, as well as how the current system is structured, do not foresee significant economic benefits in the privatization scheme. Indeed, some fear there will be more ill than good if the privatized postal savings actually went out into the already overcrowded market to make loans. Not only would this "weaken private sector financial institutions even further," according to Richard C. Koo, chief economist of Nomura Research Institute, but it would reduce the pool of funds that currently buys up much of the government's very large floatation of debt. While a hard-core fiscal disciplinarian might regard this as just the sort of shock a profligate state needs, the consequences would almost certainly include escalating interest rates as well as cuts elsewhere in the budget to finance the increasing burden of debt repayment.]*

*Hara notes the intriguing possibility that the American fiscal authorities have their eye on the postal savings funds. They need massive funds to finance the past few years of big tax cuts and large-scale wars, an unprecedented and unwholesome marriage in American fiscal history. And they will need even more money now that fallout from the New Orleans fiasco has convinced the Bush regime of the need to buy back popular support with big-state spending. With virtually zero savings at home, America has to look abroad to finance its deficits. It has been able to count on the Bank of Japan, Japan's central bank, for much of this cash, but the BOJ now holds about US\$ 800 billion in US Treasury bonds. To see the privatized postal savings get in line with the depleted BOJ at Treasury auctions would likely bring tears of joy to the eyes of US debt management specialists. Yet with the long-term prospects for the US dollar dim, Japan's postal savings depositors may soon have tears of another kind in their eyes. Japan Focus]*

With the ruling Liberal Democratic Party's landslide victory in the latest election, the postal privatization bills are highly likely to pass the Diet.

Yet, it is still quite uncertain whether the average Japanese will really feel the benefits of postal privatization.

During the campaign, Prime Minister Koizumi Junichiro emphasized that reducing the number of government employees is an important structural reform, and he pointed to the 260,000 employees of Japan Post.

But their salaries are paid by revenues from the postal services--not by taxes--so decreasing their numbers will not largely help to reduce the country's skyrocketing deficit.

Before the election campaign started, Koizumi's government frequently explained the economic merits of postal privatization as if chanting a mantra. The government argued that more than 300 trillion yen held by Japan Post will flow into the private sector, thereby revitalizing the economy once the postal organization is privatized.

A tremendous number of Japanese support Koizumi's pet project, believing the plan will bring about an economic blessing. According to Teikoku Databank, a research firm, 64.1 percent of 10,566 firms said that postal privatization would benefit the economy.

But some experts question or even deny the possibility that such a money flow will ever happen. They say that many Japanese companies have rich cash flows and do not need such a huge amount of money.

"Adding Japan Post as an additional lender will worsen the already serious problem of excess lenders and will weaken private sector financial institutions even further," said Richard C. Koo, chief economist of Nomura Research Institute.

Peter J. Morgan, chief economist of HSBC securities, said: "The benefits of a redeployment of the assets of the postal financial institutions would be limited. For example, we estimate that if they had the same asset allocation as private institutions, they would increase their lending by 148 trillion yen. However, private banks already have far more deposits than they can lend out because loan demand is fundamentally weak."

So what is the final destination of the postal services money if much of the cash does not end up in the private sector? Experts say the privatized Japan Post would continue to buy government bonds or zaito bonds, which are now issued specifically for special public corporations, as long as there is no huge loan demand on the part of nonfinancial firms. This scenario, however, would be a nightmare for those who think that a privatized Japan Post won't buy the bonds. They want to prevent a

huge amount of funds from flowing into money-wasting public corporations, thus increasing the government's mammoth debt.

Yet preventing the privatized organization from buying the government bonds would also increase the government debt because the bond prices would likely plunge and, in turn, yields would rise sharply.

Another possibility is that once Japan Post is privatized, it could invest much money into more profitable financial products than Japanese government bonds, regardless of whether they are Japanese or foreign.

Such a possibility was reported by The Wall Street Journal last month. The Aug. 26 digital edition of the newspaper said: "Citigroup estimates that U.S. Treasuries, European bonds and Japanese and foreign stocks would be the big winners if the reform goes through."

It also said Citigroup estimates a change in ownership would drain \$1.375 trillion out of Japanese bonds, including Japanese government bonds and municipal and corporate debt, as new management searches for more lucrative investments or customers shift their business elsewhere.

Even if Japan Post's money flows into foreign countries, that may not necessarily be a bad thing for the Japanese economy. Japan, after all, needs stability in the U.S. economy with its huge federal deficits.

Economist Saito Susumu points out that from the perspective of the U.S. fiscal authorities and financial community, the imminent privatization of Japan's postal savings and insurance funds of \$3 trillion must appear to offer the extra opportunities to finance the U.S. budget and external deficits that have mushroomed much faster than they had expected. The huge fiscal stimulus such as tax cuts and war spending has swung the balance on a net borrowing basis of the American public sector at the federal, state and local government levels combined from a surplus of \$159.0 billion in 2000 to a deficit of \$553.6 billion in 2004 on a GDP account basis. The expansionary fiscal policy financed by the increased issuance of deficit-covering bonds, coupled with the Fed's extremely lax monetary policy, has indeed helped rebound the U.S. economy from the slump that had followed the burst of the stock market crash in 2000.

He said that the problem is that the buoyant U.S. economy has ballooned the U.S. current account deficit to nearly \$800 billion at an annual rate lately, requiring the U.S. economy to secure the net inflow of funds from abroad by the same amount. The Japanese government under Koizumi has already acquired generously more than \$400 billion of the U.S. treasury bonds and notes in the name of official foreign exchange reserve for the past four years.

What is potentially problematic is that investments into foreign countries, even if hedged, would be exposed to changes in exchange rates that could seriously undermine the value of the money invested abroad. If such a situation occurs, Japanese voters could be forced to ponder the meaning of the latest election, and why they supported Koizumi's pet project.

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