Abstract of the Keynote Speech by Koichi Hamada, Professor at Yale University, At the Kantei Conference on January 17, 2005

I. The postal savings system has played a very important role in the development of the Japanese economy over the course of history. It even encouraged incentives to save. Japan should maintain, as much as possible, the economies of scope and the public-good quality of postal savings in local communities that is accompanied by the use of the mail-service network that must be maintained for the future.

II. Postal savings is now so gigantic in scale that it can no longer be operated independently from highly developed domestic and international financial markets. In addition, mail services are facing increasingly fierce competition from the Internet and others. Therefore, the savings-related function of postal services should be now free from under soft budgeting restrictions of the government or local political pressures. The time is ripe, I feel, for the privatization of postal savings and other activities of Japan Post.

III. The privatization of the Japanese National Railways, which was a great success overall, can serve as reference in the privatization of postal savings. Postal-savings privatization should be promoted while making every attempt to minimize the burden of reform on concerned parties and to avoid sacrificing the public-service quality of postal savings. I hope that postal savings, as a result of privatization, will become an energizing presence in financial markets as efficient as the JRs.

Keynote Speech by Koichi Hamada, Professor at Yale University, At the Kantei Conference on January 17, 2005

Chairman, Finance Minister Tanigaki, Minister of State Takenaka, Ladies and Gentlemen:

Thank you for inviting me to the Kantei Conference today. I greatly appreciate this opportunity to enjoy a nostalgic home coming to the Cabinet Office and the Council on Economic and Fiscal Policy, or CEFP.

I. Public-Service Quality of Postal Savings should be Respected

When I was growing up, post offices played an important role in people's lives and their savings. Mail and packages were delivered quickly and accurately to every corner of the nation, and savings meant, to me, the postal savings at the nearby post office rather than the bank savings at banks that were located far away in town. In contrast to the banks that were housed in modern buildings on the main street in cities, postal offices in the countryside were operated in simple facilities and performed savings-handling services that were more or less equivalent to those of banks. Plainly clad postal workers offered the services that were essential to the members of the community. In this way, the network for the mail-distribution center and for accepting deposits worked together to support the activities of post offices. The mutual benefit achieved by offering services which differ in nature—in this case, mail services and postal savings—is referred to as the "economies of scope," which is the technical term for profit resulting from a broad scope of operations. Post office operations have supported the lives of the Japanese people by taking full advantage of these economies of scope.

The interconnection of postal savings networks with those of other financial institutions is already underway. The merits of linking the systems can be seen from the fact that post office ATMs number over 26,000 and bank ATMs only number about 3,000. Today, Post offices serve the public good in many ways. For example, Japan faces the extreme aging of its population, and many postal workers are eager to earn qualifications as caregivers and are helping out with nursing care.

The banking industry used to be sheltered by overprotective policies, the convoy system, and interest rates on savings deposits were kept low. We could even say that the banks were limiting their services to each other. (This might be too harsh a way of expressing it, but please remember bank operating hours in the days before ATMs.) Maintaining conditions under which even inefficient financial institutions could survive with the protection of the Ministry of Finance meant that major banks had a great opportunity to profit. This resulted in a give-and-take relationship between the protecting bureau and the protected banking sector.

The banking sector used to protest that competition was not fair because postal savings could receive funds from the mail-services segment or the public coffers, but it was sometimes questionable whether banks were truly managing themselves solely by their own strength. The banks claimed that Postal savings offered unfair interest rates that were higher than those offered by banks because it received government assistance. It also could be said, however, that postal savings gave a fair rate to the common Japanese people during a time when government policies set deposit interest rates at low levels. Professors Scher and Yoshino have a point when they say that postal savings played a catalytic role in altering the unfair treatment of depositors resulting from the overprotection of the banking industry.[1]

II. Impossibility of Government Management of the Vast Postal Savings Funds

In the background is the fact that postal savings offered higher interest rates and better guarantee on principal and interest, and it was possible, in some cases, for postal savings to receive support from mail-service revenues or tax revenues because it was a government enterprise. As a result, postal savings (Yucho) and the postal life insurance (kampo) developed by leaps and bounds until today the postal savings unit has become the largest financial intermediary in the world. The savings unit collects more than the total deposits of the four major Japanese banks combined in scale. While the individual deposits are received in a hometown-community setting, together they go out as a huge “megabank” boasting a total of 350 trillion yen in deposits. These activities use the economies of scale in collecting deposits as inlet of funds, but for investments as outlet of funds it exploits nothing but the economies of scale, .If the market principle is not followed in the operation of such a huge amount of capital, various inefficiencies will arise. Inefficiencies will arise if the postal savings account and the mail service account are not clearly separated in terms of accounting procedures, or, in other words, if

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[1] Scher, Mark J., and Naoyuki Yoshino, eds. *Small Savings Mobilization and Asian Economic Development*. London: M.E. Sharpe, 2004.

accounting is done by rule of thumb, or "in the same bowl (donburi kanjo)." An exceptionally high interest rate was offered for fixed-amount postal savings at the maturity during the time of almost zero interest rates. This should not occur if the interest rate mechanism is functioning efficiently.

Moreover, in an era of low or near-zero interest rates, financial institutions cannot survive with fixed profit margins only. Financial institutions must make a profit by hedging risks via derivatives, such as futures and options. Postal savings, with the largest assets in the world, should be allowed, or necessitated to make profits in this way as well. Because postal savings is essentially a large-scale "bank," it would be natural for it to seek to achieve the best possible profitability of the funds as the fund operator while maintaining postal savings' public-service functions that are so important to rural communities. In other words, it would be natural for postal savings to seek to achieve efficiency on a par with the best in the financial industry today in order to increase its volume of funds. This sense becomes even stronger when you remember that the postal savings collected via the nationwide network of post offices is directly related to international financial markets in which transactions designed to make a profit are conducted by minutes or by seconds.

There is a risk that there may come a point where it is impossible for such a volume of funds to be operated efficiently by a government enterprise which is bound by laws and operates under a bureaucratic structure. If a clear budgetary wall is absent in the relationship with mail services, postal savings may sell financial instruments that diverge from economic rationality and pursue investments that make no business sense. Take the case of construction, for example. A private company probably would not have built three bridge systems between Honshu and Shikoku and probably would not have yielded to political pressure from the countryside in the first place. (It is dangerous to leave investment in public property in rural districts entirely up to the political process disregarding the profitability.) In the case of employee hiring as well, although the government strives to place the right person in the right position at wages appropriate for the position, this goal is not being achieved if all the postal workers are paid uniformly throughout Japan. Retired bureaucrats and commissioned postmasters (*tokutei yûbinkyokuchô*) are not necessarily placed in positions that suit them. (Obviously, some former bureaucrats that become officers at government-related organizations are excellent, and some commissioned postmasters make a commendable contribution to activities crucial for local communities in the countryside, but not all of these people are necessarily appropriate for the positions to which they are assigned.)

Of course, it is a separate question whether all operations will be liberalized and run efficiently if Japan Post is privatized. Despite the fact that the private-sector financial industry has been liberalized, there remains a lot of government red tape even today, according to people in the business. Although Japan is a world leader in the manufacturing industry, the nation’s financial and other service industries lack vigor because the government has been overprotective and has interfered too much. The Ministry of International Trade and Industry never insisted on certain auto designs, but the Ministry of Finance has had complete and detailed control even down to the specifications for financial instruments and insurance products at times. This does not foster financial entrepreneurship.

The book edited by Professors Scher and Yoshino which I mentioned earlier is an excellent work; it is filled with comparatively balanced research about the postal savings issue and gives an excellent commentary on the economic function of postal savings. Citing cases in other Asian countries, it thoroughly discusses the issues, including the fact that the very existence of postal savings has a positive influence on people’s desire to save. (This book is probably one of the most conscientious defenses of postal savings. Other reasonable defenses are made by Kazuhito Ikeo and Eisuke Sakakibara). I must mention one problem with the book by Scher and Yoshino, however. Starting from the fact that postal savings offers products with slightly more favorable conditions in terms of capital safety and profitability than banks because postal savings has been under a soft budget to date, the book goes on to argue that the privatization of postal savings is undesirable because it would fail depositors who trust postal savings. I find this position a little too one-sided. The fact that postal savings offers, or at least has the possibility of offering, favorable conditions using funds injected from other budgets, not through the market mechanism, is a problem. Issuing savings instruments at good conditions using support from other budgets could be a downfall—not an advantage—of postal savings. The privatization of postal savings should be welcomed in principle in this sense.

Tasks for the future, however, remain: Supposing postal savings were privatized, who, with what kind of expertise, would be able to operate the huge amount of funds that would result from the privatization? The same issue would arise even if postal savings were to remain a public corporation, so this question does not constitute opposition to the push for privatization. Foreign governments as well as international financiers are afraid that the Post Savings will engage in monopolistic financial deals in a disturbing manner. I am concerned, however, being a bit nationalistic, about this huge megabank simply being hulking in size but inefficient in operation and even becoming easy prey for international hedge funds.

III. Lessons from the Success of the JR Companies

The principle underlying the policies of the Koizumi Cabinet and Minister of State Takenaka is the goal to eliminate unnecessary government involvement as much as possible and to use the vitality of the private sector to best advantage. Discussions at the CEFP and other bodies have clarified that to achieve structural reform the government and the regulatory authorities must themselves stop hiding behind the veil of power. In other words, the government must even discard its pleasure in having control. The government tries to shed its armor and has brought to the government benefits that are extremely difficult to achieve by incentives. From the outside, the Koizumi Cabinet therefore has a bit of a —please forgive the expression—Quixotic or naïve-apprentice (shosei) quality to it. The Cabinet seems to conceive of plans in a vacuum without looking at reality and the actual possibility of achieving the goals set. It is precisely these characteristics that make the Cabinet tremendously attractive to me. (I am a naïve type myself!)

In my opinion, the greatest impact of Koizumi-Takenakas' structural reforms is information provision—the process of making economic policies is now explained to the Japanese people in a much more transparent way via the CEEP. This has clarified who are against reform—who holds power or is the established power. Of course, we do not know if a given reform will be achieved as the government envisions. However, processes and decisions that to date have been performed in a nontransparent way, in a black box, are now being disclosed to the Japanese people in the form of council meeting minutes and others.

I can easily understand the negative stance toward the privatization of postal savings taken by parliamentarians whose constituencies are in the countryside and by the national association of commissioned postmasters. The Ministry of Finance is also situated in a delicate position with the selling of government bonds, and the banking industry seems to be inconsistent as well: it says it is good that postal savings will lose its privileged position, but it is nervous about the appearance of a mega financial institution. There is resistance from various quarters for various reasons, and the reform probably will not succeed unless the Japanese people fully grasp the benefits of postal-savings privatization for the national economy. Academics can appreciate that the interest rate mechanism will operate well and efficiency will be enhanced simply by shifting the flow of funds from the public sector to the private sector, but the average citizen needs an explanation of the results of the privatization of postal savings—what organization will offer what kinds of savings instruments and how will the funds be used? Economists can be persuaded merely by the claim that competition fosters efficiency. The public would like to know how to achieve it by process.

Postal savings compete with private financial institutions. The Postal Life Insurance competes with the private life insurance companies. Today is the age of the Internet, and e-mail has come to be a strong rival for mail services. Revenues from postal services are declining by 3 or 4 percent annually. Privatization is thought to be desirable in an age such as this because it will free postal operations overall from a variety of restrictions. Whether the opposition of the established powers will be overcome and privatization achieved will depend on the political might of the prime minister and Mr. Takenaka, the minister in charge of the reform.

One experience that will serve as reference for us with the postal savings question is the 1987 privatization of the Japanese National Railways (JNR) into seven companies—six regional passenger railway companies (the JRs) and one freight company (JR Freight). The JNR that was plagued by financial deficit and labor disputes has been transformed into modern railway companies that inspire envy around the world. The resolution of Prime Minister Yasuhiro Nakasone and the foresight of Hiroshi Kato, which Atsushi Kusano emphasizes in his books, as well as the efforts of many others inside and outside the JNR, including Yoshiyuki Kasai and Ryohei Kakumoto, can be said to have led to the success of JR.[2] If we set the postal savings issue aside in its current state and balk on privatization and rationalization by emphasizing the public-service character of

2 See: Kusano, Atsushi. *Kokutetsu kaikaku: Seisaku kettei geemu no shuyakutachi* (Reform of the Japanese National Railways: Key Players in the Policymaking Game). Tokyo: Chuokoronsha, 1989. Kusano, Atsushi. *Kokutetsu kaitai: JR wa gyosei kaikaku no tehon to naru no ka?* (Dismantling of the Japanese National Railways: Will JR Become a Model for Administrative Reform?). Tokyo: Kodansha, 1997. Kasai, Yoshiyuki. *Mikan no kokutetsu kaikaku* (The Unfinished Reform of the Japanese National Railways). Tokyo: Toyo Keizai, 2001. Kakumoto, Ryohei. *Kokutetsu kaikaku no kiki* (The JNR Reform Crisis). Tokyo: Seizando, 2001.

postal savings in rural areas, a situation like that of the JNR in days past may arise.

At that time, Hiroshi Mitsuzuka made the reform of the JNR into an opportunity to change the views of the Liberal Democratic Party (LDP). Will pro-reformers take advantage of the opportunity afforded by the election violations related to the special post offices (*tokutei yûbinkyoku*) to bring about a change in the divided opinion within the LDP so that more members accept the path of structural reform? Or will the opposition of LDP Diet members have the energy that will even replace the collapse of the current administration is curious to me from the perspective of political economy. By using the excuse of being abroad, I would be interested to hear your insiders' perspectives.

We must continue to take advantage of postal savings' economies of scope and nationwide networks that are made possible thanks to its link with mail services. We should try to retain the intimate sense of hometown community in Japan's rural towns. At the same time, we wish to pursue the efficiency of fund operation by the market mechanism. It would also be a waste to put a bureaucratic straightjacket on the fund-handling activities of postal savings, Japan's largest financial institution. It would be desirable for postal savings to follow the path of privatization taken by the Japanese National Railways, the Nippon Telegraph & Telephone Public Corporation, and the highway-related public corporations while gradually mollifying the opposition, and it would be desirable for the process to be accelerated. It does not concern me so much whether Japan Post should be divided into three or four companies or what kind of incentive will work in the new system. We must carefully consider whether postal savings should simply be left to operate as is—as a huge, monopolistic financial institution with red tapes—or in some other way more friendly to the interest rate mechanism. Is it not possible to split up Japan Post by region or function and make the resulting companies compete among themselves, as was the case with the creation of the JR companies? Eventually the interest rate mechanism should adeptly distribute the funds, but the details of the transition period should be considered further. Such efforts would also serve to respond to the concerns of various foreign countries about the sudden appearance of a huge, monopolistic financial institution. Japan must cautiously navigate the transition so that the new, huge influx of postal savings funds neither terrifies other countries nor becomes easy prey for international financial businesses.

From the perspective of efficiency that can be measured by profitability, there is no question that privatization via market principles is the best option. However, it is also important to protect the lifestyle benefits of people who reside in the countryside, benefits which cannot be measured only by profitability. The two objectives of efficient management and local public-service benefits in the countryside may conflict in any course of the privatization; as was the case at the time of the liberalization of the telecommunications business in the U.S. Only the political will of the prime minister will be able to decide where those two important goals can be reconciled. Can we learn from the case of the transformation of the JNR into the JR companies, however, on how to seek efficiency while protecting the public-service quality of postal operations in the countryside?

Note: The author would like to acknowledge the valuable insights he received from discussions with colleague Frances Rosenbluth, professor of political science at Yale University, and Akihiro Tada, Executive Director at JETRO New York, in drafting this paper. All views expressed in this paper, however, are solely those of the author.

Local Public Goods vs. Financial Efficiency

Koichi Hamada

Local Public Goods v.s Market Efficiency

- Conflict of public goods nature and financial efficiency
- I hardly needed any postal
- services in writing this memo.

Intimate Community Services of PS

- Banks competed for fancy buildings.
- Plainly clad in modest buildings in local community (Postal Savings) My nostalgic memory
- Community services (Elderly Care) Network Externalities, 23,000ATM vs.3,000 with Banks
- Japanese learned how to save by the Postal Savings
- Network Externalities and Economies of Scope(ATMs)

A Reference Point to Judge Banking Efficiency

- The Convoy System to help the large banks
- Depositor unfriendly.
- Role of checking the banking sector

Too big to be managed bureaucratically

- .$3.5 trillion
- To keep up with Modern Financial Marketand Technology
- Is Further Division of PS needed?

Why is public enterprise be inefficient?

- Soft budgeting
- Political influences on the local expenditure
- Red Tapes
- Parachuting

Political Economy of Vested Interests

- The process is more transparent in the Koizumi Cabinet.
- Persistence pursuit of ideas and ideals.

Lessons from the Dissolution of JNR, 1987

- Political leadership, Nakasone
- Advisers: H. Kato described by A. Kusano
- Can Yucho become like JRs or remain like the JNR?
- Constituents will see visually how privatization mean?

The Conflict between local amenity and aggregate efficiency in the national level exists.

- The leadership should explain and take responsibility for change if needed.

Local Public Goods, Network Externality

- I. The postal savings system has played a very important role in the development of the Japanese economy over the course of history. It even encouraged incentives to save. Japan should maintain, as much as possible, the economies of scope and the public-good quality of postal savings in local communities that is accompanied by the use of the mail-service network must be maintained in the future.

National Economic Efficiency

- I. Postal savings is now so gigantic in scale that it can no longer be operated independently from highly developed domestic and international financial markets. In addition, mail services are facing increasingly fierce competition from the Internet and others. Therefore, the saving-related function of postal services should be now free from under soft budgeting, restrictions of the government or local political pressures. Time is ripe, I regard, for the privatization of postal savings and other activities of Japan Post.

The Need for Political Leadership

- I. The privatization of the Japanese National Railways, which was a great success overall, can serve as reference in the privatization of postal savings. Postal-savings privatization should be promoted while making every attempt to minimize the burden of reform on concerned parties and to avoid sacrificing the public-service quality of postal savings. I hope that postal savings, as a result of privatization, will become an energizing presence in financial markets as efficient as the JRs.

January 17, 2005

Dr. Junichi Ujiie
Vice Chairman, Keizai Doyukai
Director, Center for Advanced Research in Finance,
Faculty of Economics, The University of Tokyo

Importance of Shift in Funds from Public Sector to Private Sector

1. Premises for Discussion

- Becoming genuinely private financial institutions
- Operating through fair competition

2. Significance for Users

- Creation of financial product sales channel easily accessible by public
- Enhanced competition in financial industry

3. Impact on JGB Market

- Market disrupted as result of privatization?
- Need to diversify JGB investors and types of JGBs

TOWARD A MORE RATIONAL FLOW OF FUNDS IN JAPAN

by
Kent E. Calder
Director, Reischauer Center for East Asian Studies
SAIS/Johns Hopkins University
Washington, D.C.

A. A KEY POLITICAL-ECONOMIC PATTERN: FROM STRATEGY TO COMPENSATION

(1) Government financial intervention can aid short-run economic success, especially in reconstruction.

(2) Over time, such intervention breeds pressure groups, resistant to both efficiency and true democracy.

(3) Such pressure groups naturally desire compensation in return for support, regardless of the broader public interest.

(4) In a globalized economy where growth is difficult for industrialized nations, feeding political interests is an inefficiency they cannot afford.

B. AMERICA'S EXPERIENCE WITH POSTAL SAVINGS

(1) Useful during the Depression

(2) Inefficient at dealing with postwar problems. Created invisible burdens on the public.

(3) Why America took the government out.

(4) How the private sector efficiently and smoothly provides services to local areas and agriculture today.

C. ECONOMIC REFORM AND DEMOCRACY

(1) Economic reform promotes efficiency.

(2) Economic reform promotes creative, flexible, private-sector responsiveness to social problems.

(3) Economic reform also enhances true democracy.

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EXECUTIVE SUMMARY

Necessity and Method of Keeping Fiscal Balance

Presented by Lee Kun Kyong January 17, 2005

The subject I have been asked to cover is "Necessity and Method of Keeping Fiscal Balance." My presentation will be from a Korean point of view.

Korea's Fiscal Outlook

It was in the early 1980s that the importance of sound fiscal balance began to be emphasized in Korea. Last year, the national budget of Korea accounted for 24% of its GDP, while the national outstanding debt accounted for 26% of GDP. The tax burden was about 20% of GDP. Compared with other OECD countries, the figures I mentioned are much lower.

Last year, if we exclude the national pension the consolidated fiscal balance showed a deficit of 1% of Korea's GDP. However, if we include the national pension, the fiscal balance was in the black by 1%. Except during the restructuring period of 1998 and 1999, this surplus has continued.

Necessity and method of keeping fiscal balance

□ necessities for keeping sound fiscal balance

Korea is a small open economy and therefore relatively vulnerable to external shocks. In emergency situations, the public finance should be able to play the role of a safety net capable of absorbing such external shocks. Sound fiscal balance and the level of national debt are important factors affecting sovereign risks. To prepare for future changes, today's public finance must be sound. Sound fiscal balance, once it has been lost, is very difficult to restore.

□ method of keeping fiscal balance

Social consensus is the most important factor. Environment can be created where the economics, required to keep sound fiscal balance, can overwhelm the politics. Institutions that control the increase of national debt should be established. As for tax and expenditure policies - there is a tendency for most countries to lower taxes due to tax competition. The expenditure side is becoming more important. the budget authority should have the power to say no to various demands to increase expenditure from the political circle. In Korea, the five-year fiscal plan has served to some extent for such purpose.

Issues Related to Privatization and National Pension

□ A few issues relating to privatization

Privatization can contribute to keeping sound fiscal balance, leaving aside the issue of efficiency. From 1998 to 2003, the Korean government privatized state owned enterprises in aggregate value of around US$15 billion. Recently, the Korean government has been working on the idea to privatize the right of operation of SOC facilities including roads.

□ A few issues relating to the national pension

The consolidated fiscal balance including the national pension was in surplus by 1% of GDP. The surplus of the consolidated fiscal balance will continue to rise up to 3% of GDP in the coming three years. The surplus implies that the public finance has a depressing effect rather than stimulating effect on the economy as money flows into the public sector.

There is a need to mitigate the depressing effect the surplus may have on the economy. To meet this need, the Korean government encourages the private sector to take initiative in the construction and the operation of SOC projects by providing a partial guarantee of a return on investment. This again allows the National Pension to invest in such projects due to the reduced risks. Recently, the Korean government has widened the scope of projects with partial government guarantees to schools and welfare facilities.

UBS Investment Bank

Outline of a presentation by Lord Brittan of Spennithorne, UBS Investment Bank, on "The Privatisation Experience"

17 January, 2005 at the Kantei Conference

Slide 1:

A brief explanation will be given of the three phases of UK privatisation since 1977 (Phase 1:1977-1984, Phase 2:1985-1988, Phase 3:1989 onwards) and how / in what role Lord Brittan contributed to all three phases of privatisation in the UK and policy creation for Europe. Lord Brittan will emphasise its relevance to the current proposals for Japan Post.

Slide 2:

A closer look will be taken at various privatisation objectives, some of which are ideological and some of which are pragmatic. Lord Brittan will highlight the potential conflict between these objectives and the need for government to manage such conflicts, based on UK and European experience.

Slide 3:

Lord Brittan will explain the role and importance of regulation in facilitating liberalisation and privatisation, commenting particularly on the role and status of the regulator as key factors for success.

Slide 4:

From a variety of privatisation precedents in the UK, major achievements are selected and presented from four different viewpoints: industry; the privatised company; the customer and the UK taxpayer.

Slide 5:

The direct benefits of privatisation to the UK consumer and taxpayer are demonstrated, including the subsequent reduction in electricity utility prices and the proceeds derived from the privatisation initiatives.

Slide 6:

To conclude the presentation, Lord Brittan will draw on his experiences in the EU as a whole, as well as the UK specifically, to answer one of the most frequently asked questions regarding privatisation, 'Can the public's interest still be protected?'

End of presentation

UBS Investment Bank

The privatisation experience

Lord Brittan of Spennithorne

January 2005

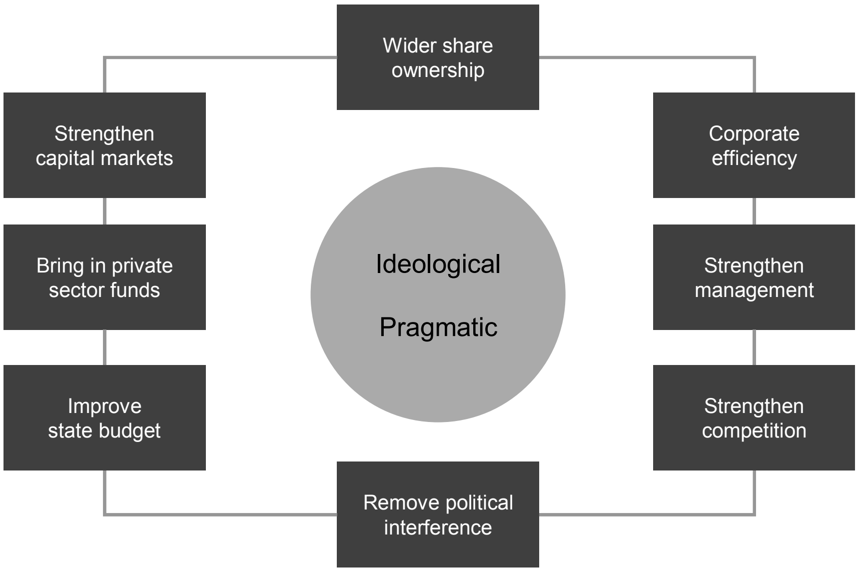
Contributing to all phases of privatisation in the UK and policy creation for Europe

Phase I 1977 to 1984	Phase II 1985 to 1988	Phase III 1989 onwards
- Increase efficiency by introducing commercial disciplines - Maximise proceeds	- Wider share ownership	- Introduce more competitive industrial structures - Public / private partnerships
1979 Minister of State at the Home Office 1981 Chief Secretary to the Treasury 1983 Home Secretary	1985 Secretary of State for Trade and Industry	1989–1999 Vice President of European Commission 1989–1992 Responsible for European Competition Policy and Financial Institutions 1993–1999 Responsible for external economic policy
British Petroleum - I (1977) British Telecom	British Gas British Petroleum - II (1987)	Electricity Rail

EU Postal Directive voted in 1997; amended with 2002 directive setting out timetable for liberalisation - full liberalisation envisaged in 2009

TPG IPO 1994	IPO 2000	Postbank IPO 2004

Privatisation objectives



Industry restructuring and regulation

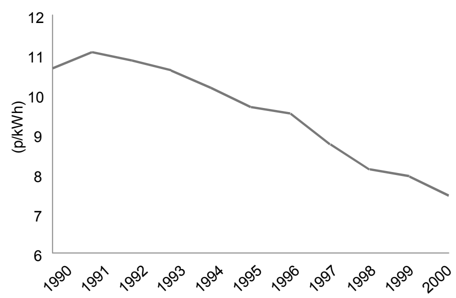
- In complex companies or industries, regulation can be used to help achieve public objectives by
  - benefitting the consumer through restricting the market power of a monopoly
  - incentivising the company to become more efficient
  - promoting best cost and service standards
  - producing the effect of competition, while enabling flexibility of industry development
  - enabling the regulator to balance the needs of the consumer with the organic development of the industry
- The role and status of the regulator is key

What has been achieved?

- For industries where privatisation has led to wider restructuring:
  - creation of vigorous competition
  - emergence of sustainable industry structures
- For companies no longer controlled by the government:
  - greater commercial freedom
  - access to a broader range of capital markets
  - improved efficiency
  - hidden cross subsidies have become unsustainable
- For customers:
  - reduced utility charges
  - improved service quality
- For the UK tax payer:
  - over £60 billion since 1977

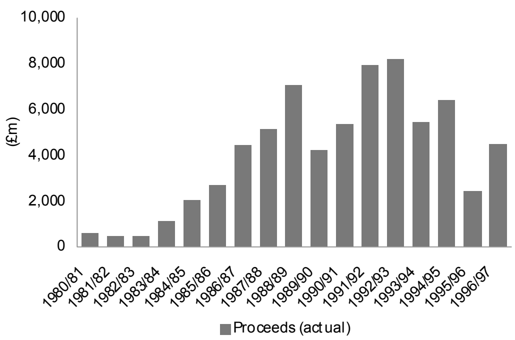
What has been achieved?

Average domestic electricity prices in the UK over the period of industry restructuring



Source: Electricity Association

Privatisation proceeds: 1979–1980 to 1996–1997



Source: OECD

Can the public's interest still be protected ?

- Yes: by
  - clear statutory frameworks imposing public service obligations
  - effective independent regulation
- Lessons learnt from the UK's rail "privatisation"
  - concept of privatisation needs to be more closely adapted to specific industry needs
- Postal privatisations across Europe
  - IPO of KPN (telecom and post) in 1994 (Netherlands), with subsequent demerger of TPG in 1998
  - Deutsche Post IPO in 2000 (Germany), with subsequent float of Postbank in 2004
  - Royal Mail plc (UK) is fully corporatised, although not yet privatised
  - sale of minority stake envisaged by Denmark and Belgium

The Point of Speech of
Toshihiko Fukui, Governor of the Bank of Japan on
January 17, 2004

1. Privatization of Japan Post and Changes in the Funds Flow

Privatization of Japan Post will produce both direct and indirect effects on financial markets and the financial system. These include not only those arising from the changes in the funds flow through Japan Post but also those due to the changes in the funds flow generated by, for example, shifts in people's investment stance in response to the privatization.

Privatization of Japan Post is expected to contribute to more efficient allocation of financial resources based on the market mechanism.

2. Promotion of Healthy Competition and Innovation in the Financial Sector

In the process of privatizing Japan Post, an equal footing with private financial institutions should be maintained. Risk management of new postal savings and life insurance companies should be conducted appropriately.

Private financial institutions should continue to enhance their soundness and stability, which have improved considerably mainly due to progress in the resolution of the nonperforming-loan problem. Furthermore, they need to provide sophisticated financial services to promote revitalization of the economy.

We hope that healthy competition and innovation will be encouraged in a situation where soundness of the financial system is maintained.

(Provisional translation)

The point of speech of Minister of Finance Sadakazu Tanigaki

(Flow of funds and fiscal structural reform)

- With regard to the flow of funds in Japan since the burst of bubble economy, the household sector has reduced its financial surplus. The corporate sector has lowered its demand for funds against the background of a sluggish economy and the need for balance sheet restructuring; this sector has recently become the largest financial surplus entity. In contrast, the government's fiscal deficit has expanded as a result of frequent economic measures and tax cuts as well as slumping revenues caused by economic weakness. Despite efforts to curb expenditures in recent years, the government has become the largest financial deficit entity partly because of the increased pressure of social security-related expenditures.
- If the government continues raising a large volume of funds, the risk is that funds will not flow "to the private sector" smoothly even when the private sector is being revitalized. That in turn may impede the realization of sustainable economic growth led by private-sector demand.
- Therefore, it is essential to downsize the public sector in order to smoothly supply funds to the private sector. To this end, we pursued and strengthened expenditure reform in the FY2005 budget formulation, exerting efforts to curb expenditures. We will continue to strive to restrain the size of government.
- We also need to secure confidence in Japan's fiscal sustainability. Thus, we must continue fiscal structural reform by both increasing revenues and curbing expenditures.

(Flow of funds and reform of the FILP)

- The overall scale of the Fiscal Investment and Loan Program (FILP) has reduced. The reforms of the FILP have contributed to the flow of funds "to the private sector."
- For a long time, the FILP had been financed mainly by the compulsory deposit of Postal Savings and Pension Reserves. Some criticized the FILP, however, since fiscal discipline had not fully worked and FILP agencies became bloated. In response to the criticism, the government had implemented fundamental reforms of the FILP in FY2001. By the reform, the requirement that all Postal Savings and Pension Reserves be deposited with the Trust Bureau was eliminated. Now, those funds that are truly essential to FILP agencies are

raised from financial markets by issuing “FILP bonds” (a type of government bonds) or “FILP agency bonds” (publicly issued bonds with no government guarantee issued by FILP agencies).

- With the reform, the direct connection between Postal Savings and the FILP is eliminated.
- Projects financed by the FILP are constantly reviewed in line with the Reorganization and Rationalization Plan for Special Public Institutions and so on. The FILP Plan has been markedly downsized every year; the total amount of the FY2005 plan is almost 60% below that of the peak year. In addition, all FILP projects were comprehensively reviewed last year, and the issue of financially unsound FILP agencies is being resolved. We will continue making the necessary efforts.

(Flow of funds and privatization of Japan Post)

- The privatization of Japan Post is among the most important tasks to promote structural reform under the principle of “from the public sector to the private sector” and to make it possible for people’s savings to be used to promote economic revitalization. The quality of services is also expected to improve as the privatized companies appropriately downsize themselves and introduce more efficient methods. Furthermore, the privatization will help improve the government’s fiscal position because the new companies will be subject to tax obligations just like any other private company and shares held by the government will be sold.
- In order to achieve the above-mentioned aims, Japan needs to adopt appropriate measures, taking into account the fact that Postal Savings and Postal Life Insurance play important roles in the flow of funds. Because Japan Post holds one-fourth of all government bonds, due and appropriate attention must be given during the transitional period to prevent any undesired impact on the government bond market.

(Closing remarks)

- Taking into account the reform’s aim of “from the public sector to the private sector” as well as the need to achieve fiscal soundness, the government must firmly avoid measures that place a burden on taxpayers in privatizing Japan Post.