CAU Asia Focus

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Postal Savings Reform in Northeast Asia

Part One: Japan and South Korea

Postal savings programs have long served as vehicles to promote savings among all segments of a population, especially those in rural and agricultural regions which are frequently without ready access to banking or other financial services. Over the past several years, there have been a number of changes to postal savings programs in the Northeast Asian economies of Japan, South Korea, and China. Most notably, all these economies are attempting to reform their traditional postal savings programs to adopt more commercial bank-like models. A number of factors are driving this change, including the large size of accumulated postal savings deposits, political pressure to narrow the income gap between rural and urban regions, and overall financial sector reform.

This issue of the *Asia Focus* is the first of a two-part series discussing recent developments affecting postal savings programs in Japan, South Korea, and China. Part One of the series reviews the historical underpinnings of the Japanese and South Korean postal savings programs and discusses recent reform efforts and current challenges. Part Two of the series will describe the development of the Chinese postal savings program and will provide a comparison of all three postal savings programs.

Japan's Early Beginnings

The oldest of the three postal savings programs, the Japanese postal savings system (JPSS), was established by the Meiji government in 1875 for the purpose of offering small-volume personal deposit accounts to promote savings among the general population, especially rural communities. Prior to 2001, the JPSS was legally bound to place its funds with the Ministry of Finance's Trust Bureau which managed the funds through the Fiscal Investment and Loan Program (FILP). The Trust Bureau invested a portion of the FILP funds in Japanese government bonds (JGB) and allocated the rest to various government-owned institutions to fulfill public policy objectives. For instance, the Japan Highway Agency used FILP funds to expand the nation's transportation infrastructure.

From a political perspective, FILP funding was the mainstay for politically attractive projects; despite competitive concerns raised by commercial banks, elected officials were loathe to modify the JPSS and to disrupt the steady source of FILP funding it provided. It was not until there was a groundswell of public support for greater transparency and reform, combined with the election of Prime Minister Junichiro Koizumi in 2001, that legislation for the privatization of the JPSS became possible.

South Korea's Historical Underpinnings

Like the JPSS, the postal savings program in South Korea can trace its beginnings to the late 19th century. South Korea's first national postal administration was established in 1884 and began collecting postal savings deposits some years later. However, it was not until the passage of the Postal Savings Law in 1962 that the current Korea Post Service (KPS) began to take shape. Unlike the JPSS, which had strong political backing due to its link with the FILP, the KPS did not have a core constituency to advocate for its continued growth and development. This was due, in part, to the history of postal savings in South Korea.

For most of its history, the KPS has been under the purview of the Ministry of Post, which was also responsible for the nation's telecommunication system. In 1977, the Ministry of Post suspended the KPS's postal savings operations, in order to focus the Ministry's limited resources on the development of telecommunication services, and transferred the responsibility for the postal savings program to the agricultural cooperatives.[1] Six years later in 1983, the KPS regained responsibility for postal savings operations. By this time, however, the agricultural cooperatives had solidified their relationship with rural and agricultural customers, depriving the KPS of its targeted customer base.

Moreover, until 2003 when the law was amended to give the KPS some flexibility in its investment options, the KPS placed the funds it collected from postal savings deposits in the general account of the Public Capital Management

[1]Most agricultural cooperatives in South Korea are located in rural areas and include, as members, farmers and other individuals who are engaged in some aspect of the agricultural industry. These agricultural cooperatives engage in a wide range of activities to benefit their members, including educational programs on farming, agricultural product storage and distribution, and financial services such as receiving deposits, extending credit, and selling insurance products to its members.

Fund (PCMF). This fund was established by the government for the integrated management of various public funds (such as the Foreign Exchange Stabilization Fund) and was operated by the Bank of Korea. Since postal savings deposits were pooled together with other sources of public funding, the link between postal savings deposits, the PCMF, and specific political interests or public policy objectives was diffused. Furthermore, the South Korean government had established state-owned specialized banks to fulfill a variety of public policy objectives. In addition to receiving capital directly from the government, these specialized banks were capable of issuing their own bonds, so they did not have to rely on government funding, the way governmental institutions in Japan relied on FILP funding.

The history of postal savings in South Korea, along with general pressure from commercial banks to limit any competitive threat presented by the KPS, could help to explain postal savings' less important role in the South Korean financial system. It was not until the sudden growth of postal savings deposits in the wake of the 1997-98 Asian financial crisis that the KPS began to receive greater public attention and increased calls for its privatization.

Growth of Savings Deposits

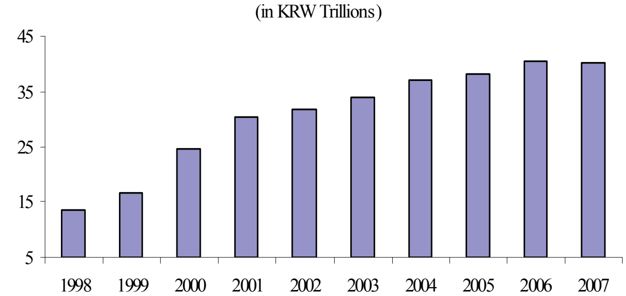
A major force driving postal privatization worldwide is the sizeable amount of accumulated deposits in postal savings programs. This is the case with both the JPSS and the KPS.

The JPSS, however, did not become a major part of the Japanese financial system until the 1970s, when its share of the financial system's deposits grew to over 15 percent. Though the JPSS's market share has fluctuated with economic conditions, the size of its holdings rose steadily until 2001. At its peak in 2000, postal savings deposits amounted to ¥260 trillion (US$2.2 trillion). The JPSS was able to attract such a large amount of household funds due to its perceived safety, underpinned by the government's guarantee of postal savings deposits, and its ability to offer long-term guaranteed interest rates. Moreover, the JPSS was ubiquitous; depositors were able to access their postal savings accounts through any of the over 24,000 post offices which were located in almost every municipality in the country.

Since 2001, when many of the saving instruments offered by the JPSS began to mature, the balance of postal savings deposits has fallen as Japanese households seek to place their savings in higher-yielding financial instruments. Nevertheless, as of March 31, 2007, the balance of postal savings deposits held by the JPSS amounted to ¥187 trillion (US$1.6 trillion[2]), making it the largest deposit base among Japanese banks. (See table 1)

Although not as large as the JPSS, the KPS also has accumulated sizeable deposits. Major growth in the KPS's deposit base came in the wake of the 1997-98 Asian financial crisis. The KPS benefited from a flight to safety by depositors eager to take advantage of the government's guarantee of postal savings deposits. Between 1998 and 2007, the level of postal savings deposits nearly tripled, with the most accelerated growth occurring between 1998 and 2001. (See chart 1)

Chart 1: Korean Postal Savings Deposits
(in KRW Trillions)



Source: Ministry of Knowledge Economy (MKE)

At its peak in 2006, the amount of postal savings deposits held at the KPS was about KRW41 trillion (US$43.9 billion[3]). With the recent proliferation of cash manage-

Table 1: Japanese Bank Ranking by Deposit Base

	Bank Name	Total Deposits As of March 31, 2007 (US$ billion)	Marketshare
1	Postal Savings Deposits	1,585.75	33.5%
2	Bank of Tokyo Mitsubishi UFJ	850.48	18.0%
3	Sumitomo Mitsui Banking Corp.	583.59	12.3%
4	Mizuho Corporate Bank	166.22	3.5%
5	Resona Bank	165.33	3.5%
6	Mizuho Bank	10.42	0.2%

Source: CEIC, Company Data, FRBSF Calculations

[2]Exchange rate as of 03/31/2007: 1US$ = JPY117.91

ment accounts and other higher-yielding financial instruments at other Korean financial institutions, the level of postal savings deposits appears to be trending slightly downward. During 2007, the level of postal savings deposits held at the KPS had slipped 2.4 percent to KRW40 trillion (US$42.8 billion). Even with the slight decline, the KPS has the sixth largest deposit base among the top ten South Korean domestic banks. (See table 2)

Postal Privatization and Politics

By 2001, the Japanese economy had experienced a prolonged period of stagnant growth, and public calls for greater transparency and more fiscal responsibility on the part of the central government were increasing. In particular, much public scrutiny focused on perceived wasteful government spending on public works projects made possible through FILP funding. It was in this political atmosphere that Prime Minister Junichiro Koizumi was elected into office on a platform for change. Among the principal reform measures he put forth was the privatization of numerous government-owned institutions including the JPSS.

Four years later in August 2005, the Koizumi Administration submitted legislation to the Japanese Diet to privatize the nation's postal system. Although the measure passed the Upper House, it met resistance in the Lower House and failed to pass. In response, Prime Minister Koizumi dissolved the Lower House and called for snap elections. The result was a landslide victory for Prime Minister Koizumi and the privatization measure easily passed in the following Diet session.

Pursuant to the new legislation, on October 1, 2007, the Japan Post Bank – along with the Japan Post Insurance, the Japan Post Service, and the Japan Post Network – began operations as a private company under the holding company of Japan Post Holdings Co., Ltd. Currently, all shares of the four entities are held by the holding company, which, in turn, is wholly owned by the government. During the coming years, shares of the holding company and the two financial entities – namely Japan Post Bank and Japan Post Insurance – will be sold publicly with the aim of fully privatizing these entities by 2017. Now that the Japan Post Bank is operating as a stand alone bank, it comes under the direct supervision of the Japanese Financial Services Agency, which is the main regulator of all financial institutions operating in Japan.

In contrast to the JPSS, the KPS has not yet begun any privatization efforts, although the push for postal reform has gained some momentum with the inauguration of President Lee Myung-bak in February 2008. While strong resistance by labor unions thwarted earlier privatization efforts in 1994, growing concern about effective oversight of postal savings deposits has given privatization efforts more urgency. Despite the size of its deposit base, the KPS is not subject to the same level of financial supervision and regulation as other domestic banks. The Ministry of Knowledge Economy (MKE), the successor agency to the Ministry of Post, oversees the KPS, including its postal savings operations. The Financial Supervisory Service (FSS) can conduct an examination of KPS's postal savings operations at the request of the MKE; however, FSS examinations are not mandatory as is the case for other financial institutions with operations in the South Korean market.

Such anomalies, along with growing public concern over the competency and financial expertise of KPS staff managing the postal savings deposits, are pressuring elected officials into action. According to press

Table 2: Korean Bank Ranking by Deposit Base

	Bank Name	**Total Deposits As of Year-end 2007** (US$ billion)	**Market share**
1	Kookmin Bank	149	17%
2	Woori Bank	119	13%
3	Shinhan Bank	105	12%
4	Hana Bank	84	9%
5	Korea Exchange Bank	48	5%
6	Postal Savings Deposits	43	5%
7	Korea First Bank	30	3%
8	Koram Bank	24	3%
9	Pusan Bank	17	2%
10	Daegu Bank	17	2%

Source: CEIC Database, MKE, FRBSF Calculations

[3] Exchange rate as of 12/31/2007: 1US$ = KRW 934.49

reports, the Grand National Party recently announced a policy that gradually would turn the KPS into a public company. No detailed plans, however, have been made public.

Challenges Going Forward

In pursuit of postal privatization, the JPSS and KPS face a variety of unique challenges as well as some common obstacles. In the case of the JPSS, the large size of its postal savings deposits and its legacy as a major purchaser of JGB present unique challenges. For instance, because of its size, the newly formed Japan Post Bank is viewed as a potential competitive threat by both large and small regional banks. As a result, these banks actively influence the political process to limit the Japan Post Bank's ability to explore new business opportunities. Additionally, while commercial banks attempt to manage interest rate risk by diversifying their investment portfolios, the large size of the Japan Post Bank's JGB holdings prevents it from taking similar actions without causing significant market disruptions. As a result, the Japan Post Bank is not in a position to maximize its earnings potential by reinvesting in higher-yielding instruments.

In the case of South Korea's postal savings program, its limited market presence and lack of a defined customer base create their own challenges. The KPS does not enjoy the same dominant market presence that the Japan Post Bank does in Japan, nor does it have a defined customer base as the South Korean agricultural cooperatives do in servicing farmers and other cooperative members. Consequently, the KPS must develop its own market niche if it is to remain a profitable entity in the highly competitive South Korean banking market.

There are also challenges common to the postal privatization process, including maintaining the financial viability of other postal business lines without the support of the postal savings business. Traditionally, revenue from the postal savings business line has been used to subsidize less profitable business lines, such as mail delivery and the management of a nationwide post office network. In the case of Japan, the Japan Post Holdings Co., Ltd. has stated its intent to cut costs and increase efficiencies, so that by the end of its ten-year transition period each business line will be self-supporting. The holding company, however, has yet to reveal concrete plans about how it will achieve this goal. Likewise, the KPS has announced its intent to expand into the "logistical support" business, but plans to derive profitability from this income source are unclear.

In addition, postal savings programs in both economies must address challenges that are common to commercial banks. Among these challenges are the recruitment and retention of skilled staff with commercial banking experience, the establishment of effective internal control systems, and the ability to compete with established financial institutions in an already competitive business environment.

Conclusion

The JPSS and the KPS share similar beginnings but developed quite differently, and now are at differing stages of privatization. The most pronounced differences between the two postal savings programs are the size of accumulated savings deposits and the operating environment (See table 3). In the case of Japan, the Japan Post Bank has a dominant market presence in Japan and any effort to expand its business is scrutinized closely by the Japanese commercial banking industry. On the other hand, the KPS has a less prominent role in the South Korean banking sector. While the size of its accumulated postal savings deposits is significant, deposits held at the KPS represent less than half the market share of each of the top three South Korean domestic banks.

At the same time, the JPSS's case makes clear that without the backing of the Koizumi Administration, bolstered by strong public support, the move to overcome the status quo and dismantle the old postal savings system would not have succeeded. It remains to be seen if the new Lee Administration will be able to garner the level of public support necessary to continue to advance postal reform and privatization in South Korea.

This discussion of size, politics, and privatization provides a context for understanding recent developments in China. Part Two of this Asia Focus series on postal savings reform will delve further into the recent establishment of the China Postal Savings Bank. In addition, Part Two will include a comparison of the postal savings programs in China, Japan, and South Korea.

Table 3: Cross-Regional Comparison of Postal Savings Reform

	JAPAN	***SOUTH KOREA***
Current Name	Japan Post Bank	Korea Post Service
Initiation of Postal Savings	1875	1905, suspended operations in 1977, and resumed deposit taking in 1983
Parent Company or Home Agency	Japan Post Holdings Co., Ltd. (100% government owned)	Ministry of Knowledge Economy
Financial Data	Deposit Base: JPY 187 trillion (US$ 1.6 trillion) As of March 31, 2007	Deposit Base: KRW 40 trillion (US$ 43 billion) As of year-end 2007
Regulatory Agency	Japanese Financial Services Agency	Ministry of Knowledge Economy
Privatization Timeframe	Start date of October 1, 2007; full privatization by 2017	No plans have been announced yet

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