Federal Reserve Bank of Cleveland September 26, 1983

Economic Commentary

ISSN 0428-1276

The Japanese Postal Savings System: A State-Run Financial Monster?

by Laura A. Kuhn

Japan maintains the highest personal savings rate of all the major industrialized countries. In 1982 the Japanese personal savings rate was about 19.3 percent of disposable income—almost three times that of the United States.[1] Many analysts consider the thrift of the Japanese people to be the primary reason for that country's tremendous industrial growth and technological advancement after World War II. Through the postal savings system (PSS), the Japanese government has converted personal savings deposits into long-term capital for industrial, trade, infrastructural, and social development. The state-run PSS has played a vital role in channeling assets to the private sector and in helping to finance the huge government deficits.

Post office savings have mushroomed in the past two decades. With a network of over 22,400 branches, the PSS had deposits of more than $330 billion in 1983:IIQ, making it the largest recipient of deposits in the world.[2] The PSS competes directly with commercial banks for personal deposits, which make up about 99 percent of its deposit base, compared with less than 40 percent for commercial banks. An attractive savings source for Japanese households, the PSS can provide more favorable rates, terms, and tax treatment than commercial banks. Consequently, the financial community is concerned about the unrestricted expansion of post office savings, which are viewed as a serious threat to the commercial banking industry. This *Economic Commentary* discusses Japan's postal savings system, its characteristics and problems, and its effect on the Japanese economy.

The Japanese Financial System

In contrast to the U.S. financial system, the Japanese financial market structure is highly specialized. The system shows extensive separation of financial activities, a comparatively high degree of regulation and control of private financial institutions by the monetary authorities, and a much more active governmental role in financial

1. For additional information on the savings rate, see Organization for Economic Cooperation and Development, *OECD Economic Outlook*, July 1983.
Although the observed frugality in household savings results from many factors, much can be explained by the rapid growth in income and by institutional factors, such as the wage payment system, the underdeveloped condition of the social security system, the limited availability of consumer and housing credit, and the tax system. See Henry C. and Mable I. Wallich, "Banking and Finance," in Hugh Patrick and Henry Rosovsky, Eds., *Asia's New Giant*, Brookings Institution (Washington: 1976), pp. 249–315.

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2. The deposits of the PSS are about three times those of the outstanding accounts of Banque Nationale de Paris (the world's largest bank in terms of deposits) and about five times those of Japan's largest bank. See Gordon F. Boreham, "The Financial System: One Reason for Japan's Success," *Canadian Banker and ICB Review*, vol. 88, no. 6 (December 1981), pp. 12–17.

intermediation and credit allocation.[3] The main overseer of almost all aspects of the Japanese financial system is the Ministry of Finance (MOF). The MOF is the powerful budget-making agency with many responsibilities, including financial management policy of the central government. The only exception to the MOF's domain is the PSS, which is under the authority of the Ministry of Posts and Telecommunications (MPT).

The central bank, the Bank of Japan (BOJ), works in concert with but under guidelines set by the MOF in determining and implementing national monetary policies. The major instruments of monetary policy available to the BOJ are similar to tools used by the Federal Reserve System. Bank credit replaces a large portion of equity capital in Japan, i.e., many Japanese firms are very highly leveraged, depending heavily on bank credit rather than on forms of internal finance. Thus, the monetary authorities rely heavily on credit controls (particularly ceilings on central bank credit to private banks) and "window guidance" (the nature and levels of bank lending being directed by the BOJ according to national economic and industrial policies). Rather than change reserve ratios or perform open-market operations, the BOJ influences financial markets primarily by changing its credit and discount policies.

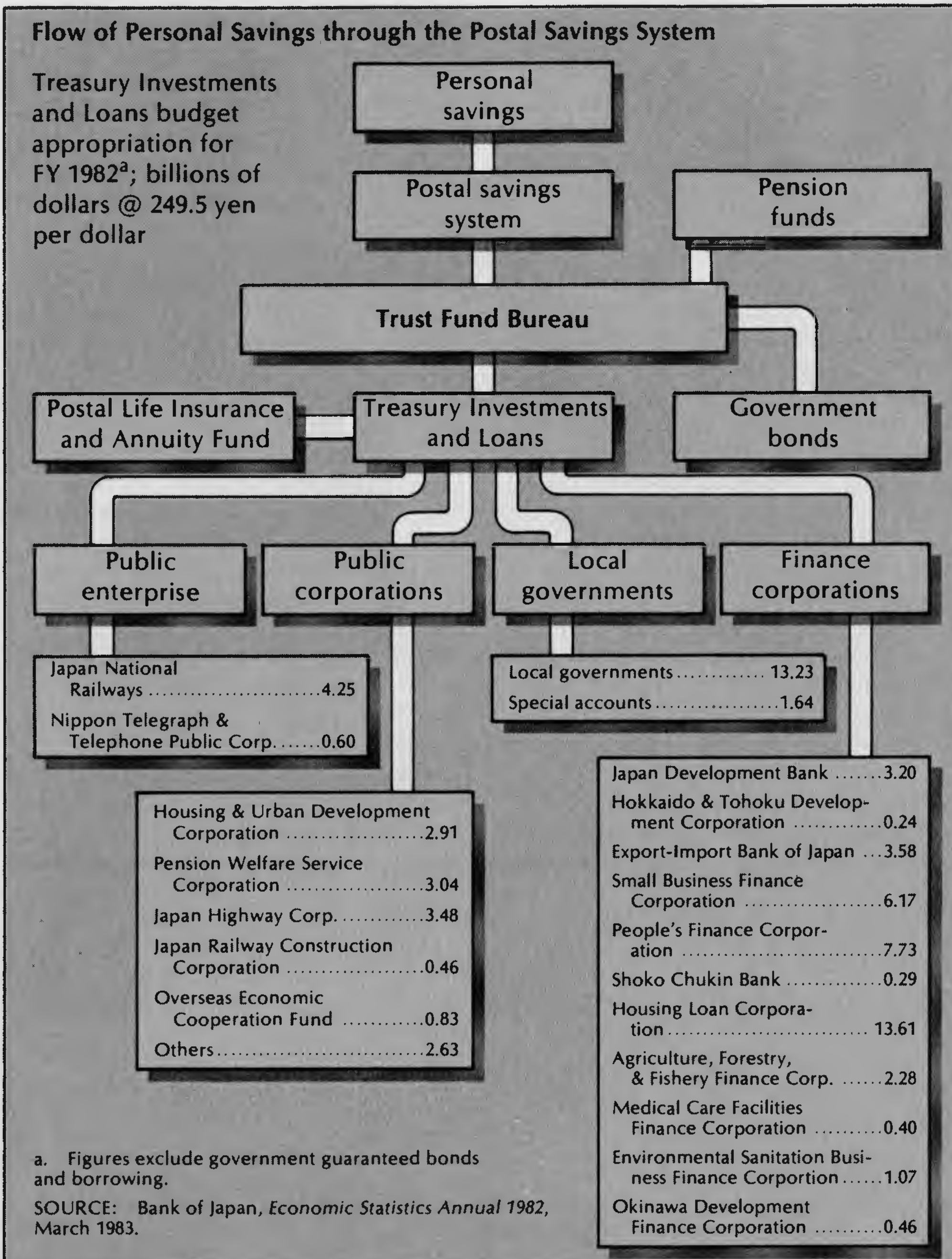
To meet the high credit demands of Japanese firms, commercial banks borrow heavily from the BOJ through its discount window. The BOJ discount rate is the foundation of the interest-rate structure of the entire financial system. Short-term interest rates, along with the lending rates of private financial institutions, generally move by the same margin as the change in the discount rate. Interest rates on postal savings deposits are again the exception, being determined independently by a committee of the MPT.

The government plays a direct and active role in financial intermediation and credit allocation. These functions are central to the implementation of Japan's industrial and social policies. Funds are channeled through a group of government-owned banks and finance corporations to promote and develop key industries, foreign trade, small- and medium-sized enterprises, agriculture, housing, and social infrastructure. The Japanese public is a major supplier of funds (savings) to these institutions, the primary intermediary being the PSS.

Post office savings, which now account for about 30 percent of the entire personal savings of Japan, are turned over to the Trust Fund Bureau (TFB) of the Ministry of Finance. The TFB channels the money, along with pension-fund payments, into areas specified for development (see figure). The TFB receives slightly more than one-half of its financial resources from post office savings and is the main supplier of funds for the Treasury Investments and Loans program. Under this program, which is determined each year along with the national budget, funds are allocated to various government-affiliated agencies. In the 1950s and 1960s, funds from Treasury Investments and Loans were used primarily for large-scale industrial projects, foreign-trade finance, and promotion of small- and medium-sized enterprises. The focus of the program shifted in the 1970s to mortgage financing and social development, reflecting the maturation of the industrial structure and the real need for social infrastructure investment. The current phase emphasizes energy resources and technology as well. Last year Treasury Investments and Loans channeled more than $72 billion into government-lending institutions, and appropriation requests for FY 1983 rose to a high of $86 billion.

Postal savings funds also are used, via the TFB, to finance part of the government's budget deficit. Absorbing almost

3. For an overview of Japan's financial system and a description of the current liberalization process, see Charles Pigott, "Financial Reform in Japan," in Financial Development and Reform in the Pacific Basin, Federal Reserve Bank of San Francisco, *Economic Review*, no. 1 (Winter 1983), pp. 25–46.



one-fourth of the total government bonds outstanding, the TFB serves as an outlet for bonds that the central bank purchases in the secondary market. The underwriting of government bonds is, however, one of the more controversial uses of postal savings proceeds. Making it easier for the government to maintain expenditures in excess of revenues may lead to an expansion in the fiscal deficit.

Reasons for Growth

The PSS has become highly controversial, primarily because the size of its financial base has grown at such an astonishing rate over the past 20 years. In the mid-1960s, PSS deposits topped the 2 trillion yen level, swelling to over 24 trillion yen by 1975—a growth of 9 times in 10 years. The growth of postal savings deposits has been particularly steep in recent years, soaring to over 80 trillion yen in August 1983. The PSS has captured an increasingly larger share of personal savings, while the share of commercial banks and savings institutions has declined steadily since the mid-1960s. PSS deposits now total more than five times the deposits of Japan's largest commercial bank.

There are several reasons for the rapid growth of postal savings and individuals' increasing preference for this system over other financial institutions. With more than twice as many branches as all commercial banking institutions combined, the PSS is very accessible to depositors, even in remote parts of the country. In addition to installing cash dispensers at the major post offices, the PSS recently implemented an on-line computerized network that enables depositors to withdraw or deposit at any one of a myriad of nationwide branches. The PSS has mustered a strong political backing within local governments and in the Diet (parliament). This political strength has aided in the passage of favorable legislation, the most important elements of which are preferential rates, terms, and tax treatment. The private banking industry views these advantages as grossly unfair, considering the PSS to be a "state-run financial monster."

Preferential tax treatment. In contrast to the United States, where tax preference primarily is given to consumption (or borrowing), the Japanese government promotes saving and grants special tax exemptions to encourage personal savings. Under the current Japanese tax system, an individual is exempt from taxes on interest income from bank deposits and bonds with a principal balance of up to 3 million yen (about $13,000) and on the interest income from an additional 3 million yen in post-office accounts. Interest on postal savings is always tax free, but an individual can hold no more than 3 million yen in this type of account.

The absence of required formal reporting of PSS accounts has led to widespread abuse of tax-exemption privileges. With little difficulty, individuals can open multiple accounts in excess of the legal limit. In 1980 the PSS maintained a phenomenal 310 million accounts—more than two and one-half times the total Japanese population.[4] Unfortunately, tax evasion is relatively easy and fairly common, much to the dismay of the government whose budget deficit amounted to $44 billion last year. In contrast, savers at private financial institutions must file a return to receive tax exemptions, making it fairly easy to monitor these accounts. Bank deposits are cross-checked to ensure that the 35 percent withholding tax on interest is deducted from any proceeds over the tax-exempt limit.

Interest-rate advantages. Another issue in the postal savings controversy is the dual system by which interest rates are set. Postal savings rates are decided by a special committee of the MPT, while a committee of the finance ministry and the central bank set market and bank account rates. Because the PSS is not under the jurisdiction of the monetary authorities, PSS deposits generally earn higher rates of interest than bank deposits.

Lending and the Allocation of Capital

The disparity of interest rates in favor of the PSS and the security and flexibility provided by its accounts have steadily drained funds from private commercial banks. Post office savings are now posing a threat to commercial banks, not only in the accumulation of deposits but also in lending to both private industry and individuals. The lending share of commercial banks has declined consistently in the past two

4. Of the total postal savings accounts, 240 million were time deposits (about 80 percent of the total) and 70 million were ordinary deposits. See Masahiko Ishizuka, "Juggernaut in Domestic Financial Scene?," *Japan Economic Journal*, October 7, 1980.

decades, sliding to 39 percent of total loans outstanding in 1982 from 55 percent in 1960. On the other hand, the lending share of government-related financial organizations has increased steadily. The sustained expansion of loans made by the Trust Fund Bureau—from 10 percent of the total in 1960 to the current 22.7 percent—has been instrumental in lowering the banking industry's share of the lending pie. Since funds garnered in the PSS are channeled, via the Trust Fund Bureau, to governmental lending institutions and hence to private industry, the more money post offices absorb and make available for lending, the steeper the competition is among commercial banks.

The private financial sector, in effect, must compete directly with an institution whose activities are outside the market economy. Thus, the flow of funds is being directed, to a significant extent, by governmental bodies rather than by the free market; i.e., the tremendous growth of postal savings deposits has created a substantial flow of credit from the private to the public sector, bypassing the market mechanism. A question of efficiency and equity then arises concerning the appropriate allocation of funds in the nation's economy as a whole.

Major portions of the funds channeled through government financial institutions via the Treasury Investments and Loans program went into housing (26.2 percent in FY 1981), small enterprise promotion (19.6 percent), living environment (13.9 percent), and transportation and communication (10.1 percent).[5] These sectors often find it difficult to attract capital without paying a premium. Moreover, the social and economic benefits derived from public intervention may justify the intervention itself. Intertwined with criticism over the handling of postal savings is the issue of the government's "crowding out" the private sector by encroaching on areas of private financing. Competition between government and private financial institutions is escalating in such fields as shipbuilding and construction of hotels and cement factories.

The government's choice to rely on administrative control in the allocation of resources proved to be extremely effective during the reconstruction of the Japanese economy because of the underdeveloped condition of the capital market. Now, as the capital market matures, and as economic growth slows and corporate financial demand declines, the appropriateness of extensive governmental influence over the flow of funds is being questioned.

Implications for Monetary Policy

The PSS sets interest rates paid on its own deposits independently of the monetary authorities. The usual resistance of the MPT to cut interest rates on postal savings accounts when the BOJ decides to lower the discount rate influences the timing of money market effects desired by the BOJ. When declines of interest rates on postal deposits lag behind those of private financial institutions, a shift of funds to the PSS often results, reducing the share of funds made available through private sources, particularly smaller banks and thrift institutions. In July 1972 and in May 1977, for example, when interest-rate declines in PSS accounts lagged behind the reductions in private-sector deposits by 15 days, the total value of postal savings, as a proportion of all fixed deposits, increased substantially. For the same reason, during July-September 1980, the accounts of the Treasury moved into a sizable surplus, the counterpart of which was a record shortage of funds in the money markets.[6]

The MOF and the BOJ are advocating unification of the present two-tier decisionmaking process on interest rates, claiming that the effective operation of monetary policy is hin-

5. See "Highlight of FY1981 Budget Treasury Investments and Loans Program," *Japan Economic Journal*, January 13, 1981, p. 15.

6. "Trends in Personal Savings and Personal Financial Assets Selection," Bank of Japan, Special Paper #93 (April 1981), pp. 15–16.

dered because such a large source of funds is outside the scope of their direct control. The extent to which the PSS has reduced monetary control in Japan is not clear, however. Although the PSS maintains a large share of personal deposits and the percentage of loans generated by commercial banks has steadily declined, the PSS channels the vast majority of its funds through government agencies. Because the MOF monitors these agencies (loan rates have to be approved by the MOF), the overall range of monetary and credit control has not been diminished by the shift to postal savings—the composition has merely changed. If, however, the PSS follows through with plans to expand its own lending capacity (currently a personal loan of up to about $2,800 per borrower is allowed) to include housing finance and educational loans, the credit it extends will be outside the control of the monetary authorities and could weaken the effectiveness of monetary policy.

Conclusion

The Japanese government has played an active and important role in financial intermediation and credit allocation. By collecting personal savings through the PSS and then allocating them to public institutions, the Japanese government has structured an effective system that functions in concert with its industrial and social policies. Although unsophisticated in terms of free-market fluctuations, this system provided the needed capital for postwar economic reconstruction. Now, however, the financial community is concerned about the power that the PSS has amassed and the encroachment of government institutions in areas of private-sector finance. The debate centers around the issue of whether a bureaucracy is better qualified to direct the flow of credit than a private market. Also debated is how increased governmental intervention will affect the efficiency of a free-market system. Determining the appropriateness of government vs. private financing is a problem not peculiar to the Japanese situation. Indeed, American policymakers are now raising similar issues about the development of a national industrial policy.

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