

The Privatization of Public Utilities in Recent Years in Japan

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I Organization of the Public Enterprise Sector in Postwar Japan

Public enterprises play a much smaller role in the Japanese economy than in Europe. During the 1970s, in the United Kingdom, France, and Italy, the public enterprise sector accounted for 8–12 percent of GDP, 8–12 percent of the labor force, and 20–35 percent of gross domestic fixed capital investment. During the same period in Japan, it accounted for only about 5 percent of GDP, roughly 5 percent of the work force, and about 10 percent of fixed investment.¹⁾

Three public corporations and five government departments are the large-scale constituents of this small public enterprise sector of postwar Japan. Public corporations were established when tobacco, railways, and telegraph and telephone services were transferred from government departments to public corporations by order of the Supreme Commander for

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1) Yoshihiro Tōyama, *Gendai Kokigyo Soron* (Contemporary Public Enterprise), 1987, pp. 111, 129, and 265.

the Allied Powers on July 22, 1948. Thus, the Japan Tobacco and Salt Public Corporation (JTSPC) was established by the Act of 1948, the Japanese National Railways (JNR) by the Act of 1948, and the Nippon Telegraph and Telephone Public Corporation (NTTPC) by the Act of 1952. Five government departments remained the same as in prewar times in terms of business organization: the Post Office, Forestry Agency, Printing Bureau, Mint Bureau, and Monopoly in Alcohol Bureau. Beside these, there are three public corporations for loans and finance, about ten special business entities in the form of joint-stock companies that are wholly or partially state-owned, and about one hundred semiindependent corporations having special status.

Together, these are referred to as the national public enterprise. There are also many municipal operations handled by more than 3,000 local authorities, mainly in the public utility industries. Recently, their numbers have increased rapidly due to the expansion of sewerage. Especially after 1988, they grew by one hundred a year, to a little more than 10,000 in 1995. They are local government enterprises in the public interest.

To run more commercial businesses for public goods, there are many mixed enterprises, termed the “third sector.”²⁾ These are formed jointly by a local authority (or several local authorities) and some private investors (in usual cases or one private investor in the special case). As of 1995, there were 1,544 mixed enterprises.

II The Background of Privatization

Private enterprise contributed much to the economic growth and development of Japan in the postwar period. In contrast, public enterprises added to the government's fiscal burden and generated consumer dissatisfaction. There are five main reasons that the Japanese public enterprises including public utilities under government management have not operated efficiently and have suffered serious losses.³⁾

1 Reasons for Poor Performance of the Japanese Public Enterprise

(1) Legal Monopolies and Lack of Competition

Many public enterprises are national monopolies, and private entry into their line of business is restricted legally. Undertakings too large for proper management have suffered from many inefficiency factors — delay in decision making under a hierarchical system, the tendency to shift responsibility to others, inefficiency due to remote control, and low morale in the workplace. Monopolies have eliminated competition, which is essential for promoting efficiency, and have not met consumers' needs.

2) This has a totally different meaning in Japan than in the United States. In Japan it refers to a joint-stock company financed by a local authority (or several authorities) and some private investors with the aim of local development or local promotion (*Ibid.*, Chap. 10, esp. pp. 236–9).

3) *Ibid.*, pp. 153–56. And also, Yoshihiro Toyama, “Privatization of Public Enterprises and Its Problems in Japan,” *International Journal of Social Economics*, Volume 25, Number 2, 3, 4, pp. 389–90.

For example, managers of the JNR at every level lacked a sense of responsibility and could not control the workers, so there were often wildcat strikes.

(2) Political Interference in Management

In theory, public corporations are free from ministerial control over management, as distinct from policy. In reality, however, political interference often prevented rational economic decision making or imposed irrational decisions on managers against their will. Business could not be conducted efficiently, and deficits resulted.

For example, the pressure of Diet members from certain local areas prevented the JNR from closing some unprofitable lines and forced it to set up money-losing new local lines.

(3) Legal Restrictions on Business Scope

Public enterprises are given monopoly in exchange for not pursuing related side businesses. At first, guaranteed monopoly was of more benefit than diversification. As economic structures changed and profitable new businesses arose, however, public enterprises seemed to have the worst of the bargain. Although protected from competition, they were deprived of wider scope.⁴⁾ This seriously demoralized both labor and management in public enterprises.

For example, private railways covered the low-level earnings in or losses from their rail business by gains from related activities, but the JNR could not do so, and its deficit became by far the largest among all business entities in Japan.

(4) Financial Restrictions

Governmental control over the finances of public enterprises is very wide and rigid, and these often depend on government for capital expenditures and for operating costs. Public corporations can not decide freely on fares, on opening new businesses, on raising capital, or on improving their services. Bureaucratic management is not receptive to new ideas.

In the JNR case, the budget, prices (passenger fares and freight charges), audits, and other matters were subject to ministerial control.

(5) "The Treasury is Behind Us"

In the private sector, the punishment for inefficiency and the luck of an enterprising spirit is bankruptcy. Public enterprises consider themselves immune from bankruptcy, that is, the government will bail them out even if their performance is extremely poor. An easygoing way of thinking "the Treasury is behind us" spread to all public enterprises in Japan. Both management and workers lived in peace while neglecting consumers.

This appeared most typically in the JNR case. In utter disregard for passengers and freight shippers, laborers of the JNR often went on strike or staged slowdowns with an irrational slogan of anti-rationalization, and managers were indifferent in the face of huge deficits.

4) Leonard Tivey, *Nationalization in British Industry*, 1966, 2nd ed., 1973, p. 194.

2 Establishment of the Provisional Commission for Administrative Reform

On March 16, 1981, the Provisional Commission for Administrative Reform (PCAR) was established to advise the prime minister to reform administration, and its report emphasized the urgent need for administrative reform and public enterprise reform. Policy measures for the privatization and rationalization of the three large public corporations were proposed.

There were intense arguments for and against privatization from inside and outside of the government and the three public corporations. Most Liberal Democrats favored it, except some who had special relations with the three public corporations. Socialists and Communists were strongly opposed, as were the trade unions associated with the public enterprises. Consumers generally supported privatization. At last agreement was reached after many complications.

As the result of strong opposition inside and outside the government, the eventual privatization legislation involved many compromises. The drastic reforms recommended by the PCAR were considerably modified. This was especially the case regarding the NTTPC and JTSPC; JNR privatization more closely followed the PCAR's proposal. Details about two public utilities are given as under.

III Privatization of the NTTPC

1 Differences Between the PCAR Recommendation and the 1984 Legislation

The PCAR proposed that the NTTPC be changed to a special business entity with stock held by the government; the shares gradually would be offered to the public until all were sold. The 1984 legislation specified that share offering be under Diet authority, be limited to two-thirds of all shares in the end, and be less than one half within five years after privatization. The PCAR recommended a five-year reorganization into a central business entity responsible for the trunk circuit; regional business entities to bundle local services; and separate entities for residential and data communication services. Also, maintenance services would be partially separated from NTT. But the law made no provisions for reorganization.

2 Selling the Shares of NTT

The government first sold shares in NTT in October 1986, followed by two other offerings. At the end of 1997, 34.67 percent of holdings had been sold, well below the target of two-thirds. The offered volume is now insufficient, and the offering prices are low because of an extreme slump in the stock market, after the bubble boom evaporated in 1991.

3 Changes in Privatized NTT

NTT has made remarkable changes as a private company. It lost its monopolistic position but in return got freedom to expand its business in related fields. So it established subsidiary or associated companies and developed new business actively. By March 1986, one

year after privatization, it had established sixteen companies in the field of communications, software, and VAN; nine in information networking; and eleven others in real estate or human resources. Forty-nine more were set up the following year. Privatization substantially raised the morale of NTT's staff. The attitude toward consumers has improved dramatically, and customer satisfaction is now a primary goal.

There is also significant competition between NTT and newcomers since entry liberalization, although there is still some degree of regulation in the public interest. But NTT is by far the dominant player and must compete while at the same time helping rivals develop. NTT's profits reached 500 billion yen in 1988, but since then they have decreased substantially.

NTT separated out data communications in May 1988 and mobile communications in July 1992. The Telecommunications Council's proposal for further separation/division and the granting of new company stocks to existing shareholders were frozen by the ruling party. After a very active discussion inside and outside government, however, revisions to the Nippon Telegraph and Telephone Co. Act were announced on June 20, 1997. Within two and a half years after this announcement, NTT should be divided into a central company dealing with the trunk network and two-regional companies dealing with local telephone service.

IV Privatization of the JNR

1 Establishment of JR Group Companies

The 1986 law privatized the JNR virtually along the lines of the PCAR's proposal. On April 1, 1987, six companies were created mostly for passenger service (Hokkaido Railway Co., East Japan Railway Co., Central Japan Railway Co., West Japan Railway Co., Shikoku Railway Co., and Kyushu Railway Co.) and one for freight (Japan Freight Railway Co.). They are called JR group companies.

These are joint-stock corporations in which the JNR makes investment in kind, but the act does not prescribe government share holdings. (Ideally, all shares will be offered for public subscription.) The JNR's long-term liabilities fell to the three passenger companies (East, Central, and West) on the main island, Honshu, and to the freight company, but not to the other passenger companies which are invariably in the red because of relatively few passengers. The new enterprises are to be regulated by the same law governing private railways.

2 Selling the Shares of Three Companies in Honshu

The government sold 61.5 percent of the shares of East Japan Railway immediately before public presentation of the stock in October 1993, but the rest are unsold. Plans to sell West shares failed because of serious damage after a major earthquake in January 1995, and Central shares simply because it did not sell. In April 1996 the government announced that West stocks would be listed the following October, and Japan Freight stocks would be sold in the next fiscal year. The latter had to invite investors because it is in the

red. Toward the end of 1997, the government had sold 67.9 percent of the West shares and 60.5 percent of the Central shares.

3 Changes in Privatized JR Companies

JR companies have made a remarkable effort to function as private companies in the true sense, for example, by renewing rolling stock, improving passenger facilities, and actively developing related businesses. These steps are especially remarkable in areas in which there is competition from private railways. Special note must be made of the dramatic change in attitude — from unionism above all else to putting the customer first.

Most JR companies are now in the black, although the Hokkaido, Shikoku, and Kyushu enterprises still receive government subsidy for structural reasons. Before privatization, the JNR raised fares several times to make up the deficit, but the three companies in Honshu (East, Central, and West) did not raise fares for these eleven years after privatization, except on April 1, 1989, when a new consumption tax went into effect, and again on April 1, 1997, when the tax was increased. Besides these two times, three companies receiving government subsidy (Hokkaido, Shikoku, and Kyushu) raised their fares, only once, on October 1, 1996.

Among other changes, the strikes so frequent in the past decreased sharply after privatization. Also, though greater distances were covered, the number of railway accidents declined by 30 percent in 1997. Rather than requiring subsidies, the JR companies as a whole contribute 200 billion yen in tax revenues in 1997. These improvements are due largely to better cooperation between labor and management, higher morale among workers, and the rationalizations brought about by new technology.

V Problems in Privatization

Privatization means denationalization in a narrow sense and deregulation⁵⁾ in a wider sense including denationalization in some cases and not in others. There are some problems in both respects in Japan.

1 Imperfection in Denationalization

Denationalization has been incomplete. First, sales of shares in privatized corporations have not been entirely successful, so they are all mixed enterprises except Japan Airlines which was a mixed enterprise originally. In the case of NTT, there is an upper limit on the number of shares offered to the public, and even that has not been reached. The government is still the largest stockholder, though not as much as before.

Second, in some cases shares have not sold at all. Even if these corporations are called privatized enterprises, they effectively remain public in terms of ownership. Nevertheless,

5) Tōyama, *Gendai Kokigyo Soron*, pp. 277–79.

they are now regulated by commercial law like other private enterprises, not by public law like in the past.

Third, in Japan, privatized enterprises did not give any favorable treatment to their buyers and their shareholders, not like in the United Kingdom. Shareholding is not as popular in Japan as savings. Current economic conditions are a factor, but even when they improve, a government policy is needed to encourage stockholding in privatized corporations, which are less appealing than private enterprises in general.

2 Delay in Deregulation

Privatization in Japan has centered on denationalization, like in the United Kingdom. Deregulation has made very slow progress in Japan, where 40.9 percent of all industries, in terms of their contribution to GDP, were regulated by the government in 1993. Comparable figures for the United States were 28.9 percent in 1980 and 23.3 percent in 1992.⁶⁾

Several explanations are possible. First, due to vote maximization,⁷⁾ government policies have always favored producers more than consumers. Second, there is strong opposition by some politicians and bureaucrats, in the former group owing to vested interests and in the latter because of departmental interests. Third, certain industries are accustomed to regulation and resist exposure to competition.

Privatization in Japan is imperfect in denationalization and delayed in deregulation. Perfect denationalization and active deregulation remain as two important tasks in the future of privatization in Japan for the “interests of consumers,” the last aim of privatization.

VI The Future of Privatization

The three large public corporations were privatized, and privatization has not made remarkable progress since. Recently, some large-scale public enterprises have been mentioned as candidates for privatization — Postal Savings, Jutaku-Toshi Seibi Kodan (Housing and Urban Development Corporation), and Nippon Doro Kodan (Japanese Highway Corporation). As of 1996, Teito Kosokudo Kotsu Eidan (Metropolitan Rapid Transit Authority) is scheduled to be privatized after about five years, with continued public refinancing. As noted earlier, a bill related to the postal service was pending in the House of Councilors. After that, postal saving was decided not to be privatized with postal service and postal insurance, but to be under public corporation management.

Many public utilities under local government management are in trouble. As of March 1997, 15.3 percent of 3,611 water supply entities, 5.8 percent of 2,235 sewerage entities, all of the nine subways, and 51.9 percent of 54 bus companies were in the red. The Ministry of Local Government Affairs has been pursuing a definite policy to improve matters through re-

6) Paul W. MacAvoy ed., *Deregulation and Privatization in the United States*, 1995, p. 5.

7) See Anthony Downs, *An Economic Theory of Democracy*, 1957, Chaps. 15 – 16.

organization, merger, or privatization or third-sector management. But the privatization of local public utilities is rare at present.

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