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PRIVATIZING STATE-OWNED ENTERPRISES: A JAPANESE CASE STUDY

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INTRODUCTION

Japan's industrial competitiveness and trading skills have been trumpeted endlessly in the U.S. and elsewhere. Yet Japan's mounting budget deficits and the inefficiency of its government are virtually unknown outside of Japan. Total government debt in Japan reached 52 percent of GNP in 1984, higher than the 47 percent in Britain, 45 percent in the U.S., and 21 percent in West Germany.

Confronted by this, Japan has launched a program to slash the debt without raising taxes. It is based on the privatization of government-owned enterprises and offers a way of trimming government spending without cutting services. It thus avoids the political minefield of asking voters to give up benefits and privileges.

To be sure, few Japanese enterprises since World War II have been government-owned. These mainly have been three huge public corporations: Japan National Railway (JNR), the Nippon Telegraph and Telephone Public Corporation (NTT), and the Japan Tobacco and Salt Public Corporation (JTS). Japan Air Lines (JAL) is a semi-public corporation in which the government owns 35 percent of the stock.

The burden on the Japanese taxpayer of even this limited government ownership has been immense. By 1983, for example, the railway was losing about $25 million daily and had accumulated more than $120 billion short and long term debts. With 420,000 workers, Japan National Railway is one of the most inefficient and overstaffed railroads in the world. It has several times as many employees per revenue mile as any other railroad system in the industrialized world.[1] Losses and featherbedding in the other public enterprises are equally alarming.

Soon after becoming Prime Minister in 1982, Yasuhiro Nakasone introduced bills of privatization to the Japanese Diet. His first bills were for privatizing Nippon Telegraph and Telephone Public Corporation (NTT) and Japan Tobacco and Salt Public Corporation (JTS). By last year, they were being managed privately, although still owned by the state. Nakasone then introduced a bill transferring the railway to private management. Later this year he plans to introduce a bill calling for the sale of government-held stock in Japan Air Lines. Both bills are scheduled to be executed by next year.

Japan will benefit enormously from privatization. The railway's annual loss, which amounts to almost 20 percent of Japan's annual $50 billion deficit, eventually will be plugged. Selling government-owned assets and stocks will bring additional money into the treasury. And the deregulation that has been accompanying privatization will stimulate economic growth, increase tax revenues, and open further Japan's markets to foreigners.

To be sure, Nakasone faced powerful opposition to his privatization strategy. This included:

Labor Unions. Government corporations have the largest and most powerful labor union in Japan, which argued that privatization would reduce the number of workers and would transfer worker loyalty from the union to the company.

Leftists. The Japanese Socialist Party, the second largest political party in the country, and the Japanese Communist Party strongly opposed privatization because their main support comes from the unions.

Bureaucrats. Government bureaucrats predictably were loath to lose their power within these public corporations.

Some LDP members. Even Nakasone's own political party, the ruling Liberal Democratic Party (LDP), included members benefiting from government control of the corporations and thus fought against privatization.

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1. Peter F. Drucker, "Clouds Forming Across the Japanese Sun," The Wall Street Journal, July 13, 1982.

Nakasone has been able to deflect much of this opposition by creating personal advisory bodies that bypass the bureaucracy, appointing pro-privatization presidents to these corporations, and urging private firms to hire the public corporation employees made redundant by privatization, especially those in the Japan National Railway.

From Brazil to France and from Turkey to West Germany, meanwhile, government officials are rediscovering the virtues of the free market economy. The Reagan Administration, too, is embarking on a privatization strategy of its own. It is firmly pushing ahead with plans to denationalize Conrail, public housing, the postal service, and other publicly held monopolies. And Britain's Prime Minister Margaret Thatcher's success in selling off such state assets as the oil, aerospace, and automobile industries, is a model for U.S. privatization policies. Now, Japan's experience will add to the demonstration of benefits in allowing private enterprise into the public sector.

JAPAN'S SOARING NATIONAL DEBT

Japan's total national debt stands at $700 billion. This is the result of Japanese economic policies and the jarring economic events of the 1970s. Prior to that time, Japan followed the balanced budget policy introduced by the U.S. occupation forces following World War II. As late as 1960, the ratio of Japanese government expenditures to GNP was smaller than that of any Western country. The ratio that year was 18 percent for Japan, compared to 30 percent for the U.S. and 38 percent for Britain.

In the early 1970s, the commitment to small government and a balanced budget was abandoned as Japanese economists fell under the influence of the Keynesian economic theory, which advocated government intervention and an expanding welfare state. Pressure from the U.S. also pushed Japan toward budget deficits. Japan at that time was experiencing the very high economic growth rate of about 10 percent annually with low inflation and a trade surplus of $6 billion with the U.S. The Nixon Administration demanded in the early 1970s that Japan stimulate its domestic economy with government spending to increase imports from the U.S. Tokyo complied by raising wages for government employees and expanding social welfare, public works, and other government programs.

As a result, the annual budget jumped from 20 percent of GNP in 1971 to 34 percent in 1981. Social security expenditures soared from 4.5 percent of GNP in 1971 to 11 percent in 1981.[2]

These "big government" policies along with the explosion of oil prices sparked the highest inflation rate in Japan's postwar history, reaching a staggering 25 percent in 1975 and depressing overall economic growth. Japan's national debt began to increase by 4 to 5 percent of GNP each year. In 1980, Prime Minister Zenko Suzuki came to office vowing to "slash the national debt." He began by holding down outlays for social security, education, government salaries, and agriculture subsidies. The annual growth rate of government expenditures fell from double-digit figures in the 1970s to an average of about 4 percent for the last five years.[3] Japan's annual government budget deficit also dropped significantly.

Trimming government spending, however, proved to be politically risky. Bureaucrats, Liberal Democratic Party members, opposition party members, labor unions, farmers, and others strongly opposed cuts in their programs. Opposition became so fierce that Suzuki was forced to resign in 1982 after only two years in office. A member of his Cabinet, Yasuhiro Nakasone, who was directing the Administrative Reform Department, succeeded him as Prime Minister.

PRIVATIZATION UNDER NAKASONE

Once in office, Nakasone continued trimming the growth of government spending. But he also tackled the deficit problem in a new way: he sought to privatize the Japan National Railway, Nippon Telegraph and Telephone Public Corporation, and the Japanese Tobacco and Salt Public Corporation--and to sell the government's stock in Japan Air Lines (JAL).

Japan's government-owned corporations seriously drained the treasury under the economic stimulation policies of 1972 because of the higher wages and larger retirement pensions included in the expansionist government budget. As the Japanese economy slowed during the 1970s, the drain became more pronounced. Government subsidies to keep the corporations afloat, meanwhile, made them more inefficient and increased their debt.

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2. OECD Economic Surveys Japan, Organization for Economic Cooperation and Development, July 1983.

3. Quarterly Economic Review, Nomura Research Institute, Vol. 16. No. 2, May 1986.

Political opposition to Nakasone's privatization plans was vociferous. Labor unions, facing a loss of power and privilege, mounted a general strike; political parties, which depend on labor votes and financial support, blocked the privatization bills in the Diet; and entrenched government bureaucrats, who stood to lose their regulatory authority, attempted to sabotage the process.

In addition, there was great concern among people who depend upon the services provided by the public corporations. Commuters and office workers, for example, raised questions about whether railway fares would rise or services be curtailed.

In order to overcome these objections, Nakasone took steps to:

1) Assure the public that the government only gradually would transfer the assets and management of the state-owned corporations to the private sector and would not lower the quality of service.

2) Strongly urge private businesses to offer employment to those public corporation employees who voluntarily left their jobs.

3) Give extraordinary power to his personal advisory bodies and policy deliberation councils to bypass the parliamentary debates and bureaucratic sabotage.

4) Replace the president and executive officers of the public corporations who were not only balking at privatization but had close political connections with anti-denationalization factions in the ruling Liberal Democratic Party (LDP). Nakasone, for example, dismissed the Japan National Railway president and installed his own man, an unprecedented action in postwar Japan.

5) Appeal to the public through the mass media. As a result, all newspapers have given considerable coverage to the collapse of railway worker discipline and the ineptitude of railway officials under state control and ownership.

JAPAN NATIONAL RAILWAY (JNR)

The JNR became the main target for Nakasone's privatization, especially after JNR's own streamlining attempts failed completely in 1983. The collision between the labor union and management demonstrated that there was no hope for the rehabilitation of the JNR under state ownership. In 1983, the railroad employed 420,000 workers, lost $25 million a day, and staggered under more than $120 billion in debts.

To accomplish JNR's privatization, Nakasone's strategy has included:

** Establishing a private advisory body, the Special Administrative Research Council. The advantage of such a private body is that it can bypass any stalling tactics that might be employed by politicians or bureaucrats who oppose privatization. In 1983, this Council recommended:

1) Eliminating around 200,000 JNR jobs by 1985, bringing the level down to 180,000 by 1987. This is proceeding on schedule.

2) Splitting the national railway system into six regional passenger railway companies and one nationwide freight company in 1987. (The stock in these enterprises, for some time, will be held by the government.) This too is on schedule.

3) Transfering JNR to private management by 1987.

4) Allowing JNR to expand its business into such fields as hotels, shopping centers, and real estate development.

** Creating the JNR Reform Commission in 1983, which has been seeking to:

1) Reduce the work force by urging employees to take early retirement or to move to such private companies connected with JNR as its catering services or to other private companies. Some 150,000 have left already, with 90,000 expected to find jobs outside JNR or retire by next year.

2) Reshuffle the JNR management team in a manner that will speed the privatization process.

** Introducing by the end of this year a JNR reform bill to the Diet, thus making the privatization procedure official. With Nakasone's ruling LDP controlling the Diet, the bill is expected to pass.

** Selling a large portion of nonrailway assets, mainly valuable land, to help pay the old debt. Even so, the government will have to "write off" about $70 billion of the estimated $157 billion debt. Three of the new companies, the Hokkaido, Shikoku, and Kyushu lines, will be free from any obligation to assist in paying off "old JNR" debts, while the other four companies will together assume about $100 million of those debts.

JNR privatization, of course, will not be complete until the government actually relinquishes its ownership of the railways. What is troubling about this is that Nakasone's plans are very vague. All that his government says is that it gradually will sell stock to the public of those railway companies that become profitable. Privately, government aides predict that all seven railways will be profitable by 1990 and that all of their stock will be bought by the private sector by 1995.

NIPPON TELEGRAPH AND TELEPHONE PUBLIC CORPORATION (NTT)

Privatization of NTT began in April 1985 with the legal transfer of its management from the government to the private sector. Compared to the JNR case, the process has been smooth. For one thing, NTT was not losing money as JNR was. Thus, NTT's 320,000 employees could remain with the company as it was being privatized. For another, pro-privatization NTT managers, including the president, have been politically active in the privatization process. NTT's unions, moreover, favor privatization. The reason: as a state enterprise, NTT had linked its salary levels to those at JNR and at government agencies. NTT employees thus concluded that their salaries would increase under private management. And because NTT was not divided into regional companies as JNR will be, the public has not worried that NTT's basic services will be curtailed.

NTT was quite confident that technologically it could compete with any new companies in the telecommunications industry. In fact, privatization was seen as a way to make it even more competitive. The belief among political leaders was that private management and a competitive environment would encourage greater technical innovation and permit NTT to adapt quickly to changing telecommunication technology. It was hoped, moreover, that forcing NTT to face competition would lead to better service to consumers and open the Japanese telecommunications equipment market to foreign competitors--an important point in trade talks with the U.S.

The Nakasone strategy for NTT privatization included:

** Passing a NTT privatization bill in the spring of 1984 that converted the enterprise into a privately managed corporation in April 1985. This ended 116 years of government management.

** Stripping NTT of its monopoly privileges. Immediately, new companies such as Daini Denden, Inc., Japan Telecom Co., Ltd., and Teleway Japan Ltd., were established, and others are being formed. They will compete with NTT in the telecommunications market, especially between such large cities as Tokyo and Osaka. Along with opening the common carrier market, Nakasone deregulated secondary network service areas like the value-added networks (VAN), which perform such data transmission tasks as money transfers for the banking industry and credit card verifications. This has spurred formation of joint U.S.-Japanese ventures. Examples: IBM and NTT; General Electric Corporation and Japan's NEC Corporation; and U.S. Tymnet and Hitachi Ltd.

The government will sell 12 percent of NTT stock to the public this fall and plans to sell an additional 12 to 15 percent each year for the next four years. The government will retain 30 percent of the stock for the foreseeable future. The Japanese Ministry of Finance expects that sale of the 70 percent of NTT stock will bring six to eight trillion yen (or 40 to 50 billion U.S. dollars at the current exchange rate) into the Japanese treasury.

JAPAN TOBACCO AND SALT PUBLIC CORPORATION (JTS)

In contrast to the smooth sailing of the NTT privatization bill, efforts to privatize the 75-year-old, government-run tobacco and salt monopoly encountered stiff opposition. It came from the 90,000 tobacco farmers who wield strong leverage within Nakasone's Liberal Democratic Party. They fear that "complete" JTS privatization will prompt massive imports of tobacco leaf from at least a score of nations that produce the crop at much lower prices than Japan. Opposition also came from the Ministry of Finance, which feared losing some of the $1.7 billion annually contributed to the treasury by JTS. And labor leaders were apprehensive that a reduced Japanese domestic tobacco industry would mean fewer union members.

Bowing to strong political pressure, Nakasone rejected the most sweeping recommendations of the Administrative Reform Council, his private advisory body. It had called for completely abolishing the JTS monopoly powers in tobacco manufacturing. Nakasone agreed to maintain JTS status as sole producer of cigarettes and buyer of domestic tobacco leaf even after privatization. Even so, Nakasone proposed measures that would begin the JTS privatization process by transferring control from bureaucratic hands to private management. As important, it abolished the JTS monopoly on distributing cigarettes. Foreign manufacturers, who formerly had to distribute their products through JTS, now can set up their own networks. Already, the U.S. tobacco giants of R. J. Reynolds Tobacco Co. and Philip Morris Companies, Inc., have forged links with Japanese firms to distribute American cigarettes.

Nakasone's compromise on JTS privatization became law in mid-1984. The following April, JTS was transformed into a privately managed corporation--Japan Tobacco, Inc. (JTI). During each of the next four years, 12 percent of the government's stock in JTI will be sold to the public. Privately, government officials predict that all of the stock eventually will be in private hands. Officially, however, the Nakasone government says that the state will retain 52 percent of the stock for the indefinite future.

JAPAN AIR LINES (JAL)

Unlike the railway, telecommunications, and tobacco corporations, JAL has been managed privately since it was founded as a semi-government corporation in 1951. Initially the government owned nearly 60 percent of the shares, but gradually reduced this to 35 percent. JAL is regarded as one of the world's best-managed airlines. Still, the Nakasone government concluded that there is no reason for the government to remain a shareholder. Without the state as a partner, JAL may be able to respond more rapidly and flexibly to market developments. Indeed, bureaucratic intervention and state financial assistance have spawned irresponsible management and poor morale among JAL's 20,000 workers. The crash of a JAL 747 jumbo passenger jet into a mountainside near Tokyo in August 1985 dramatized many of the company's serious management problems. Other airlines in Japan, moreover, are fully in private hands.

To privatize JAL, Nakasone appointed a new president and chairman of the airline last October to restructure the JAL before a scheduled "total" privatization next July. Then last spring, the government allowed All Nippon Airlines, a privately owned Japanese carier, to begin flying Pacific routes, ending JAL's monopoly of international routes. This fall, the Diet is expected to approve these measures in a JAL privatization and anti-monopoly bill. And a few months later, the remaining government-held JAL stock will be released slowly on the market for private investors.

BENEFITS OF PRIVATIZATION

Though the Nakasone government has treated each public corporation in quite a different way, the objective has been the same: transforming a managerial system based on state ownership and control into private management and eventual private ownership. Nakasone expects a number of benefits from privatization. Among them:

1) Reduction of the annual budget deficit by about 20 percent or $10 billion.

2) An infusion of nearly $100 billion into the government treasury from sales of stock in the state-owned enterprises.

3) Increased efficiency that will stimulate the Japanese economy to expand, thus yielding substantial additional tax revenue.

4) More open markets, thus benefiting Japanese consumers and foreign competitors.

CONCLUSION

Rejuvenating the domestic economy and reducing the national debt by selling state-run enterprises is not only a Japanese phenomenon. It initially started in Britain when Conservative Prime Minister Margaret Thatcher came to power in 1979. Her government already has sold $28 billion worth of state assets, including public housing and major publicly owned companies in the automotive, telephone, and aerospace industries. The British government is planning to privatize British Airways, British Gas, government-owned airports, and many other public enterprises. Privatization has not only helped Thatcher balance her budget, it has rejuvenated the private sector.

From denationalizing the cotton mills in Pakistan to privatizing the state airline in Turkey to bringing the nationalized industrial giants to the stock market in formerly socialist France, world leaders are following Thatcher's lead. So doing, they provide their citizens with a more efficient private sector, a less intrusive or costly public sector, and a greater range of choices for the individual in what he consumes or where he works.

Under the Reagan Administration, the U.S., too, is embarking on privatizing electric power companies, Conrail, Amtrak, public housing, the postal service, airports, and other holdings. Because of strong resistance from Congress, however, the pace of privatization has been much slower than elsewhere.

What began six years ago in Britain as a rigid doctrine to roll back the frontiers of the state has come to be seen as pragmatic and routine in the industrial democracies and other countries as well. The privatization movement is an important global phenomenon, which recognizes the importance of free market vitality in rejuvenating stagnant national economies hide-bound by state planners and managers. Japan's experience will be a valuable addition to this trend.