

ment in Japanese companies. We might expect even less variation over time of workers across industries than we found for GDP; however, employment change is more highly skewed than GDP. The Japanese curve lies outside the American at every point, despite the bias towards heterogeneity from the greater number of American industries. The Gini coefficients calculated from these samples confirm the visual inference: the Japanese coefficient was 1.06 compared with the American value of 0.47. Moreover, Japanese employment growth continued to become more unequal throughout the 1990s.

A good deal of the Japanese employment story can be told by just two sectors – agriculture and services; the decline of the former and rapid growth of the latter account for much of the dispersion from 1970 to 2000. Construction and trade (wholesale and retail) were the other main movers on the plus side, while textiles lost jobs over much of the period.

Conclusions

The Japanese economy became more heterogeneous in the last decade or so of the twentieth century. The 1990s are a convenient marker, although some changes began earlier and others took shape later in the decade. The lingering rigidities imposed by the post-war model of economic development finally gave way to the cumulative pressures of slower growth, deregulation and foreign entry. In short, one could argue that pent-up change finally broke loose from the frictions of earlier policies and practices, forced by dislocations in the underlying economic foundations. These changes are evident in the increased amount of variations across industry.

10 The privatization of Japan's public corporations

Privatization of large government undertakings has been a central theme in the deregulation and liberalization of the Japanese economy. Privatization of the government's highway corporation and postal system were at the top of Prime Minister Junichiro Koizumi's agenda in his attempt to redesign Japanese politics, the LDP and the economy. By most measures, the actual privatization measures were drastically weakened versions of original plans. Given the disappointment with the progress made in this campaign, it may be worthwhile to examine privatization in the 1980s under the aegis of Prime Minister Yasuhiro Nakasone.

The results of the earlier effort were mixed. On the plus side, the former government-owned enterprises were transformed into more efficient, profitable and competitive organizations than they were in 1980. However, only a handful of the companies were fully privatized, and the enormous debt of the nationalized railroads was not reduced. The same kind of political barriers that prevented Mr Koizumi from fully realizing his goals also placed constraints on the previous attempts. Ministries, agencies and bureaucrats often barred the way toward fuller privatization, chiefly because they did not want to lose control over the industries and companies that they supervised. The concept of industrial planning under government management that had survived from the 1930s was a continuing factor in the extended and partial process of privatization.

Japan's public economic enterprises

Historical background of privatization

Many of Japan's state-owned industries had military or strategic economic origins. Government ownership of railroads and telecommunications was asserted to be necessary for military coordination as well as for industrial development. The post-Second World War development of aviation carried these same rationales, although the military reason was muted in Japan compared with its use in other countries' justification of state-owned airlines, including the United States.

Japan's salt and tobacco monopoly is another matter; those products were the traditional targets of state control, mainly for revenue purposes, going back to

the Roman Empire's monopoly of salt. Tobacco, from an early stage of its introduction into Europe, also fell under state monopolization in the 1670s. Salt and tobacco shared similar characteristics: they were widely used and absorbed small shares of personal income; in addition, the quantity consumed was insensitive to price, especially if its use was addictive. Under these conditions, large profits could be earned by raising prices well beyond the marginal cost of production, but only if competitors could be barred from entering the market. Thus, if a government could establish the monopoly for itself, it could raise prices and enjoy the revenues.

Government ownership of railroads, telecommunications, airlines and the salt and tobacco monopoly came under intense scrutiny in the early 1980s because of debt, inefficiency and declining competitiveness, especially compared with performance in private companies in Japan and other countries. A drive to privatize these industries was pushed by business interests and popular sentiment, but was opposed by those who had profited from state ownership or who would be penalized by privatization and market liberalization. The political power of small groups and their supporters among Diet members as well as government agencies that would lose authority over their supervisory charges blocked the complete sale of government corporations to the public. After 25 years, only three railroads and the government-owned airline were sold off completely. The government still owns substantial shares of the telecommunications company and the tobacco company. No shares in three non-privatized passenger rail lines and a freight rail company have been sold to the public.

The public corporations included the largest employers in Japan: Japanese National Railways (JNR) and Nippon Telegraph and Telephone (NTT). NTT's privatization transactions constituted the largest initial and secondary offerings ever up to that time. In addition to these two companies, the Japan Monopoly Corporation – the only authorized buyer and seller of tobacco, tobacco products and salt – was converted to a private company (Japan Tobacco) and partially sold off in the 1990s. Japan Airlines Co., Ltd. was founded as a private company in 1951; under a 1953 law allowing government ownership, the company was reorganized as a public corporation, with the government holding 49 per cent of the shares (later diluted to 34.5 per cent). In November 1987, the government divested all its shares as part of the broader drive to privatize public corporations.

Although these conversions were large-scale events and required major political efforts to accomplish, Japan's nationalized production capacity was not as large a part of its economy as that of many other advanced or developing countries. In comparison with the United Kingdom, France and Germany, for example, there was remarkably little public enterprise in Japan in the late 1970s. Whereas the European countries had nationalized all or parts of their postal, electricity, gas, oil, coal, steel, shipbuilding and automobile industries – as well as railroads, telecommunication and airlines – Japan's only government-owned production companies were in the last three sectors and the post office. Among the advanced economies, only the United States had a smaller share of nationalized industries than Japan (Calder 1990: 164).

Japan actually had gone through several phases of nationalization and privatization in the years following the Meiji Restoration of 1868. In the 1870s, the government inaugurated a programme of state industries to serve several national objectives: to teach production techniques to private firms; to stimulate import substitution; and to foster industries important for military purposes. However, the government factories were a severe drain on government finances. Their poor profitability, the rise of an entrepreneur class and the government's need for cash to finance military activities led to privatization starting in 1880.

Military demands stimulated the next phase of government industrialization after the Sino-Japanese war of 1894–95. The following year the government created the Yawata Iron and Steel Works. Following the Russo-Japanese war of 1905, more than 90 per cent of the railway system was nationalized and the government embarked on a major investment in new lines and rolling stock. However, the large conglomerates (*zaibatsu*) strongly opposed government intervention in the economy; subsequently, most of the expansion of government-owned facilities occurred in Japan's East Asian colonies, with private companies involved profitably as builders and managers.

As war in Asia and the Pacific expanded in the 1930s, military industry again became the focus for nationalization. Yawata Steel combined with several smaller, private firms to become Japan Steel in 1934. By 1939, the MOF was a major shareholder in a wide range of strategic manufacturing firms and trading companies. As the war progressed, the government extended its reach to include the electricity generation business.

In the immediate post-war years, price controls and other government interventions in the economy set the stage for still further takeovers of formerly private businesses – a process that consolidated wartime policies. This process reached its height when the Socialist Party briefly gained control of the government in 1947–48. The Socialists attempted to nationalize the coal industry following the practices of its European counterparts. (See Chapter 6 for details.) However, vigorous opposition from the more conservative parties in the Diet as well as mine owners forced considerable weakening of the proposed law. The Dodge Line, designed to bring discipline to the fiscal and monetary situation, first weakened and then in September 1949 ended this attempt at nationalization (Samuels 1987: 103).

A conservative government, which owed no allegiance to the labour unions, took power at the same time that the post-war Occupation authorities implemented a new economic policy that included a balanced government budget for the first time in decades. The mounting losses of the state-owned companies were affected by the fiscal belt tightening. From 1948 to 1949, the number of government employees fell by more than 100,000. By 1951, most of the nationalized firms had been privatized. NTT and JNR, which had been bureaus in their respective ministries, were converted into independent public corporations, wholly owned by the government.

However, as the conversion of state-owned production enterprises into private establishments was occurring, a new effort was under way to create another class

of government organizations with business functions – banking and financial organizations. These new ventures were financed by off-budget funds, unchecked by Mr Dodge and his Occupation staff; the financing was drawn from the postal savings system via the Fiscal Investment and Loan Program (FILP). Japan's rapid growth in subsequent decades swelled postal savings and gave the government a growing trove to finance activities without the necessity of going before the Diet for budget approval. Borrowing an organizational form common in Japanese colonial administration in Manchuria, the government created scores of new so-called parastatal organizations. These were used to manage the enormous expansion of infrastructure in the 1960s and 1970s. They also provided a convenient vehicle to reward the friends of the LDP with construction contracts and to serve as retirement homes for senior civil servants. By 2001, there were 157 government-affiliated corporations and other special government institutions, which became the targets for a second round of privatization under Prime Minister Junichiro Koizumi.

Rationale of the 1980s privatization drive

Japan's double-digit growth rate in the 1950s and 1960s led to even higher rates of tax revenue growth, which permitted rising expenditures without the fear of deficit spending. Additionally, money flowing into the FILP from household deposits in the postal system provided another source of revenues to back economic and political objectives.

Post-war government planners, pushed at first by American Occupation officials, took steps to eliminate the perceived dangers of unbalanced public finances. The government had the authority to use bonds to finance investment, reflecting the theory that long-lasting construction projects that would yield benefits over many years could be financed by debt whereas current revenues should pay for current transactions. Until 1974, the bonds issued by Tokyo in any year did not exceed the value of public works expenditures.

By 1975, however, in the aftermath of the first oil crisis and slowing growth, a recession-induced drop in revenues threatened to leave the government with insufficient funds to meet budgeted expenditures. To make it possible to issue debt to finance current outlays, the Diet passed the Fiscal Exception Law, which authorized, for one year only, deficit-covering bonds. That constraint, though, was elastic. The ratio of outstanding central government debt to GDP, which was 10 per cent in 1975, rose to 30 per cent in 1980 and 40 per cent in 1985. The regulated rigidities of the financial system made it difficult to fund the increasing bond issues. The MOF in 1980 warned that Japanese public finances were facing an emergency. Although it announced at every opportunity its intention of returning to sound fiscal practices, deficit-financing bonds were issued every year until 1989.

One obvious way to deal with the mounting deficits was to raise taxes. However, the business community, under the leadership of the Japan Federation of Economic Organizations (*Keidanren*), fought both the introduction of new taxes

such as a value-added tax or consumption tax and the raising of existing ones (especially corporate taxes). The business community argued that the first task should be to cut the fat in the government's own administrative structure, and then, if necessary, consider tax increases. The business sector observed that, unlike its own cost-cutting approach to dealing with economic slowdown, the government – especially public corporations – had accumulated ever-increasing deficits, liabilities, personnel, excessive wages and profligate work practices (Choi 1991: 112).

In 1980, the business sector adopted the slogan, 'Administrative Reform without Tax Increase'. Despite the sloganeering, it was clear to analysts at the time that no amount of fat trimming and subsidy pruning could bring the budget into balance without reform of the tax structure. Nevertheless, administrative reform became the principal symbol for addressing the deficits (Choi 1991: 118).

In March 1981, Prime Minister Zenko Suzuki established the second Provisional Commission on Administrative Reform (PCAR), modelled after a 1961 attempt to rationalize government. It was situated in the Administrative Management Agency. He appointed *Keidanren* leader, 84-year-old Toshio Doko, to chair the panel of independent experts constituting the PCAR.

One of the forces preparing the way for administrative reform in Japan was the rhetoric and examples of deregulation and privatization in the United States and the United Kingdom espoused by Ronald Reagan and Margaret Thatcher. These conservative politicians and their free-market ideologies resonated with their Japanese counterparts. In addition, the country had been running deficits for five years by the time the second panel was appointed.

The personality of the players also played a role in legitimizing reform. As head of *Keidanren*, Mr Doko brought along business support for his efforts. Just as important was his own public personality, that of an effective manager and entrepreneur who had successfully restructured the troubled *Ishikawajima Heavy Industries*. A lover of Chinese classical poetry, he had the image of someone who was personally austere; it was often said, for example, that he washed out his own clothes on business trips.

Another important personality was Yasuhiro Nakasone. Mr Suzuki assigned the younger Nakasone, a potential rival, to head the low-status Administrative Management Agency. Nakasone seized on administrative reform as the vehicle for his own rise in the public's eye and in intraparty manoeuvring. He took on the task with great energy and soon the prime minister joined him as a strong supporter of reform (Vogel 1996: 57).

The PCAR chair and its eight commission members included three from business, two labour leaders, two former civil servants, one journalist and an academic. Most of the chiefs or deputies of the various subcommittees and working groups were Nakasone friends, acquaintances or colleagues.

Before accepting the chairman's post, Mr Doko sent a note to the prime minister requesting a document of agreement to four conditions: (1) the prime minister should actively promote recommended reforms; (2) financial reconstruction should not include increased taxes; (3) administrative reform should occur in both

the central and local governments; and (4) the recommendations should include solving the privatization of public enterprises and the deficits in the 'three Ks': the rice subsidy (*komei*), the national health insurance system (*kokumin kenko hoken*) and the Japanese National Railways (*kokutetsu*). A week later Mr Suzuki replied that he would stake his political future on realization of the reforms.

The focus of administrative reform soon settled on the three Ks with JNR as the biggest single target. The railroad had become a symbol of government waste; it had been running enormous deficits for years, was clearly overmanned, and LDP leaders saw JNR reform as a way to break public sector unions as well as the Japan Socialist Party (JSP) (Choi 1991: 394).

In 1980, subsidies to JNR came to around ¥676 billion (\$5.2 billion) and the rail operations employed roughly 200,000 redundant workers, about half the total, using the performance of Japan's private railways as a basis for comparison. (Dollar values are converted from yen at exchange rates of the period.) This situation had not arisen by accident, but was the result of implicit agreements between the LDP and JSP in the 1960s. To obtain JSP acquiescence on a wide range of issues, the LDP agreed to wage increases for public employees, which had an especially big impact on JNR because of its large workforce. For its part, the socialist party agreed to the creation of the Japan Railroad Construction Corp., which became the source of LDP patronage in routing and construction decisions. Throughout the 1960s and 1970s, JNR increased salary and benefit packages and expanded the network of unprofitable local lines, all of which led to the accumulation of deficits that the government automatically covered (Fukui 1992: 17).

NTT, in contrast to JNR, was profitable, but nonetheless was overmanned and its employees overpaid. Costs were high and the business community as well as government leaders were concerned about the new combinations of computers and electronics that were being installed in the American telecommunications system and that were likely to bypass Japan with its highly regulated, government-owned monopoly. In addition, the fact that both NTT and the tobacco company were profitable was attributed to their monopoly status rather than to their managerial effectiveness. Therefore, profitability itself was not a bar to privatization.

The second PCAR believed that the implementation failures of its predecessor 20 years earlier were based on the inability to gain acceptance by the government bureaucracy. The new commission, therefore, worked assiduously to win over the Finance Ministry. According to Steven Vogel (1996: 59), the MOF gave the commission its full support in exchange for a pledge not to threaten financial regulation.

In order to assure implementation, the commission and the government organized a public relations campaign to educate and mobilize public opinion. At first, the topic of administrative reform was a barely audible theme in public discourse. Over the next few years, though, a flood of books, pamphlets, surveys and articles hammered home the message of the scale of the three Ks problem and the necessity for reform. After Mr Nakasone became prime minister in November 1982, he staged televised performances in which he could promote the reform idea to the urban middle class. By the end of 1982, budget discussions proceeded

in an atmosphere of impending crisis. The campaign paid off with the general acceptance of major changes to reduce the deficit. In addition, the public propaganda pointed out the implications of administrative dysfunction and focused on the demoralizing effect of dependence on the state. It pointed to the 'English', 'Dutch' and 'European' diseases of economic malaise, slowing growth and rising unemployment. Members of the commission called for a Japanese way of handling the problem (Choi 1991: 132).

The privatization of the three large public corporations and the deregulation of telecommunications became the core proposals of the commission. In particular, the reform of JNR was considered to be at the heart of the recommendations because it was the symbol of the administrative and financial ills of Japan.

Thus, what had begun as a search for ways to deal with a growing fiscal deficit was transformed into a commitment for thorough administrative reform, and ended with proposals to privatize the big three public corporations. Privatization and abolition of other government enterprises, particularly in the financial sector, were taken off the table. Prime Minister Koizumi would raise the problem of the other government enterprises 20 years later.

Japan National Railways privatization

Early JNR developments

In 1872, the Japanese government built the trunk line between Tokyo and Yokohama, the country's first railway. Private companies were permitted to build only regional lines. However, the government could not fully finance the investment required for its planned system and invited private companies to participate in construction and ownership of some segments. The authorities offered incentives for private investment in return for government supervision, cooperation with the police and military, and acceptance of a government option to purchase the lines in the future. By 1889, the length of private lines exceeded government-owned tracks (Fukui 1992: 4).

The two wars that Japan fought in the following years, with China in 1895 and Russia in 1905, convinced the military that an integrated transportation system was essential for military industry and war fighting. Private industry fought against this intervention into economic affairs. In fact, the foreign minister, who was the son-in-law of the Mitsubishi company's leader, resigned from the cabinet in protest. Nevertheless, the military lobbied strenuously for nationalization. The government approved the Railways Nationalization Law in 1906, under which it purchased private lines from 17 companies that could be integrated into a national network (Ishikawa and Imashiro 1998:10). The Railway Agency (converted to the Ministry of Railways in 1920) managed the Imperial Government Railway under an accounting system that was separate from the general budget. The basic structure of what would later become the JNR was thus established in the early part of the century.

Since the highway system was primitive, the railroads had a virtual monopoly

over the shipment of passengers and goods. Opponents of nationalization maintained that lack of competition would result in the stagnation of improvements. They also argued that government management would lead to inefficiency, that excessive regulation would interfere with expeditious operations, that investment would increase the state's financial burdens and that the large scale of the enterprise would be too complex for a government bureau to manage. All of these prophecies were fulfilled (Ishikawa and Imashiro 1998:10).

Forty years later, in the immediate aftermath of the Second World War, the government requested the national railway to absorb a quarter-million repatriates from Japan's colonies, including former workers of the South Manchurian Railways. Despite the departure of female employees who had joined the company during the war, the workforce increased from 537,000 to a peak of 610,500 between 1946 and 1948 (Ishikawa and Imashiro 1998:10).

The Occupation authorities created public corporations for the railroads, NTT and the tobacco monopoly with the aim of increasing efficiency by separating operations from the government bureaucracy. The JNR public corporation was created in 1949. Its employees were given the right of collective bargaining, but were not allowed to strike. The latter restriction was deemed to be warranted by the centrality of railroads in national transportation. Highways remained inadequate and the war had destroyed much of the country's shipping capacity.

Despite the goal of an efficient, independent corporation, the JNR was given little discretion in managerial matters. Most people, including its employees and unions, continued to regard it as part of the government. A 30-year JNR veteran later wrote: 'In reality, the public corporation in Japan was created so as to preserve the Japanese bureaucracy that existed before the war. Government structures were maintained and little effort made to change the old bureaucracy.' (Ishikawa and Imashiro 1998:12).

For the 20 years following the formation of the JNR public corporation, business grew steadily: passenger-kilometres went up 5 per cent annually and freight increased at a 3.6 per cent rate. On average, JNR operated profitably as it rebuilt its infrastructure and introduced a network of bullet train (*Shinkansen*) lines. Growth and profitability, though, masked lurking problems. Rationalization efforts dictated by the Occupation authorities had reduced employment to 442,000 by 1952. However, considerable overstaffing persisted, in large part due to the absorption of the repatriated workers, which also distorted the age structure of the workforce. The burden of retirement payments would appear in the 1970s and early 1980s when more than 20,000 workers would retire every year. By 1980, personnel costs amounted to 78 per cent of JNR's operating revenues compared with 40 per cent for private railways (Fukui 1992: 15).

As the nation's road system improved and economic growth increased personal income, trucking and private automobile ownership soared. In addition, the shipping industry fully recovered and went on to become globally dominant. Aviation, too, developed rapidly; the introduction of the high-capacity Boeing 747 on the dense Tokyo-Osaka route brought competition to the *Shinkansen* lines.

National economic growth decelerated from double-digit rates in the 1960s to

just 3 per cent by the end of the 1970s. The JNR's share of passenger traffic fell from 55 per cent in 1955 to 30 per cent in 1975 and close to 20 per cent in 1985. Automobiles, which carried less than 20 per cent of all passengers in 1955, were responsible for two-thirds of the total in 1985. The absolute number of passengers carried by the JNR peaked in 1974.

The change in transportation modes hit freight even harder. The JNR took slightly more than half of the country's freight transport in 1955. Freight volume peaked in 1970, and by 1985 the JNR's share had slipped to under 5 per cent, displaced mainly by trucks and ships (Fukui 1992: 22).

The LDP's use of the JNR to promote political interests is reflected in rail line construction. Despite the dramatic declines in volumes and shares, between 1965 and 1980, the JNR added more than 600 kilometres of lines whereas the private railroads reduced their track by 1,815 kilometres. Most of the JNR's new lines were to remote areas, which accounted for more than 40 per cent of operated lines but only 5 per cent of volume. Although the company reduced by half the number of passenger cars and the kilometres run by freight trains over this period, the JNR incurred its first full-year deficit (¥230 billion) in 1964 and would never be in the black until its privatization more than 20 years later.

Most of the losses were generated by local operations. The main lines represented about half of the whole rail network, but 90 per cent of the total volume of rail transport. After deducting two special accounts – pension funds for repatriated employees and *Shinkansen* capital costs to remote areas – the main lines tended to operate profitably (Fukui 1992: 15).

Borrowing, mainly from the MOF's Trust Fund Bureau, covered the growing deficits and kept the deficits out of the regular government budget. In contrast, other countries with nationalized railroads, such as France, the United Kingdom and Germany, funded their transportation deficits through subsidies from the national budget.

Japan's approach to funding the rail line's deficits produced ballooning debt, soaring interest payments and further losses. By 1986, long-term liabilities reached ¥19.7 trillion (\$117 billion). On a per capita basis, this debt came to ¥162,000. The 1985 loss of ¥1,850 billion represented an outflow of ¥5 billion per day, or ¥15,300 per person for the year. Such figures were clearly unsustainable. By the 1980s, subsidies had climbed to around ¥650 billion annually (about \$5 billion), including wartime repatriates' retirement payments, *Shinkansen* construction costs and other special accounts (Fukui 1992: 17).

The company and government formulated at least five reconstruction plans, beginning in 1964. The first three made the same assumptions: transport volume would continue to rise; capital investment would therefore be required; and fares should be raised every three years. All of these plans were abandoned within two or three years after their adoption. The fifth plan was intended to be the final one; the LDP issued a party resolution calling it 'the plan with no successor'. Adopted in 1981, it too was abandoned.

JNR privatization and break-up

PCAR deliberations focused on the three big public corporations, especially the JNR. As an executive member of the commission staff later observed, '[w]ithout the successful reform of the JNR, administrative reform under the PCAR could not be considered a success' (Choi 1991: 407). The PCAR issued a sequence of reports during its deliberations so that the government could act on them immediately without having to wait two years for a final report.

At first, privatization and break-up were not considered. The commission's first report of July 1981 merely suggested that drastic measure – possibly including privatization – be taken for certain deficit local lines. However, a series of briefings to the commission recommended the dual proposition of privatization and break-up. The JNR management fought these recommendations, a stance that supported the commission's views that management was not up to the task of reforming itself. The commission gradually accepted the more radical approach as the only one that made sense. By November 1981, this policy had gained the support of most of the commission members; in particular, it was pushed vigorously by a former vice minister of the Ministry of Transport (MOT), who berated the JNR managers at commission meetings.

As the views coalesced, the JNR lashed back in public and enlisted the support of LDP political leaders. The JNR president, for example, complained in the press of PCAR's ignorance of the JNR situation, claiming, '[t]hey focus only on the deficit problems because they do not fully understand at all what the JNR problem is and how it has to be solved. Nevertheless, they do not even try to study it' (Choi 1991: 423). Meeting several times weekly, the subcommittee charged with public corporation reform sought to lay out the details of the issues and the policy responses in order to counter such arguments. In classic bureaucratic-political terms, they were building the record.

By the end of January 1982, the subcommittee acknowledged privatization and split-up as the official line. In the first week of February, it presented 10 emergency reform measures and urged the government to adopt them immediately. The proposals included immediate freezes on hiring, *Shinkansen* construction, and other new investment. In April, it submitted a report recommending, among other things, the creation of a JNR Restructuring Supervisory Commission to develop detailed plans that would implement the main proposals. Several troubling issues remained to be decided, including what to do about extending *Shinkansen* lines, the enormous debt accumulated by the various JNR organizations, and the timing of privatization.

A major political-bureaucratic battle then erupted over the form of the proposed supervisory commission. The PCAR had recommended that it be established with ministerial status, which would have made it equivalent in rank to the MOT. Many others wanted it to be an ordinary advisory committee under a ministry. Administrative Management Agency director Yasuhiro Nakasone intervened in the matter; he decided it would be structured as an ordinary advisory group under the prime minister's office. However, he gave it ministerial-level authority

to order ministries to provide desired information (the equivalent of subpoena power). Because of continued political sensitivities, the term 'privatization and break-up' did not appear in the enabling legislation. The law included such code phrases as, 'to strive for the establishment of an effective type of management' (Choi 1991: 435–8).

In August 1982, the government submitted the law to the Diet and established a provisional office for the new commission. However, Prime Minister Suzuki resigned in October, Nakasone took over in November and the Diet was wrapped up with a bribery scandal involving the American Lockheed Corp. and former Prime Minister Kakuei Tanaka. The law establishing the supervisory commission for the JNR reconstruction law finally passed in May 1983.

The supervisory commission expected to deliver its final report in July 1985. It was troubled by the continuing disagreement with JNR management, which, the commission members believed, would cripple any reform plans. In February, Nakasone publicly urged JNR officials who opposed reform to resign. The JNR executives continued to insist that only a unified system could serve the public interest. In June, the prime minister fired the president and vice president and named a cooperative MOT vice minister to the top post. Within days, all the top leadership positions were filled with supporters of the reform policy (Choi 1991: 449).

The supervisory commission duly published its report on schedule and the Diet passed the government's bills on 28 September 1985. The new law called for JNR privatization and break-up on 1 April 1987. The company would be split into six passenger operating companies, divided by geographic region. Earlier studies had shown that 95–99 per cent of all passenger trips took place within regions, so that this kind of split had some rationality. Separate companies were formed for Hokkaido, Kyushu and Shikoku. The main island of Honshu was divided into three zones with an independent rail company in each zone: east, west and central (Tokai region). A *Shinkansen* holding company would own the assets of the bullet train lines and lease them to the operating companies. A separate freight company would lease lines from the six new companies.

The most troubling issue was the disposition of the debt, which was estimated at more than ¥37 trillion (\$287 billion). The three main passenger companies and the *Shinkansen* holding company took on some of it. The remainder (¥25.9 trillion) was parked with the JNR Settlement Corporation. The three passenger companies on Japan's smaller main islands (Hokkaido, Shikoku and Kyushu) were spared this burden because it was thought that their profitability prospects were too bleak to shoulder any debt. In fact, a special fund was established to subsidize their operations (Fukui 1992: 43).

The reform plan assumed that shares in the six passenger lines and the freight company would be sold to the public when the companies had established a viable financial prospect. The three main companies – JR East, JR West and JR Central – met the Tokyo Stock Exchange (TSE) listing criteria by the end of fiscal 1991 (Fukui 1992: 82).

The JNR Settlement intended to liquidate its liabilities by selling its assets: the

shares of the passenger and freight lines and the excess land that had been transferred to it. The original plan called for a series of open bids on the land. However, in a political decision based on weird economic logic, the cabinet in October 1987 postponed the sale of real estate in areas where land prices were sharply rising in the belief that releasing more land on the market would only stimulate higher prices. Consequently, the JNR Settlement missed the opportunity of unloading its assets when prices were high. Two years later, when prices started to fall, it withheld property because of the realistic belief that sales would drive down the market. Consequently, the net value of its liabilities continued to increase.

Selling JR shares

The MOT abandoned its plans to sell the railway companies' shares in 1991 because of a collapsing stock market. Although an advisory committee to the ministry recommended selling each company's stake in a lump sum, it acknowledged that instalments might be required to avoid overloading the market. The companies were anxious to get the sale under way because they hoped to escape from MOT control even if the public held just a fraction of their shares. Under the law, ministry officials had the final say on such subjects as board appointments, board decisions, financing arrangements and diversification plans (*Kyodo*, 29 November 1991).

After deciding to skip a 1992 flotation, the MOT allowed JR East to apply for listing after the 1992 fiscal year's books closed (*Kyodo*, 15 March 1993). Among those opposing a share distribution was the Tokyo Stock Exchange president, concerned that such a large sale would have adverse effects on the market. What created such great anxiety was the collapse of NTT share prices following a spectacular initial public offering and rapid run-up in price (see below). Most analysts mentioned the NTT example as a cautionary experience.

JR East acted on schedule and applied in April 1993 for a listing. On listing day, 26 October, following two auctions, pandemonium ruled. A deluge of buy orders hit the exchange, but hardly anyone wanted to sell. No transactions cleared during the exchange's normal business hours. TSE officials worked to complete at least one transaction so that a price could be listed. In after-hours dealings, enough shares were rounded up to manage a single consolidated transaction.

Things did not improve on the second day of trading as more than 100,000 orders clogged the TSE computer system. Trading was suspended after 90 minutes. Exchange and finance ministry officials prevailed upon the JNR Settlement to release additional shares to the market. Late in the day, it offered around 570,000 shares at the ¥600,000 price, thereby diluting the original issue by some 29 per cent (*Wall Street Journal*, 28 October 1993).

In the days following the listing, Tokyo prices collapsed, with the JR listing getting the blame. Responsibility for the market decline as well as for the original fiasco was well distributed. TSE officials said that the MOF refused to take its advice and was concerned only with maximizing revenues to pay off the JR debt and make up for general revenue shortfalls. Finance officials said that any

problems were the exchange's, and – from their point of view – the sale was a tremendous success. Brokers complained that the listing was over-hyped and that investors liquidated their other holdings to participate in the JR East sale, which drove down the rest of the market. Table 10.1 (at the end of the chapter) summarizes all the privatization transactions.

The next planned listing was JR West, to be followed by JR Central, both tentatively scheduled for 1995. However, the Kobe earthquake of January 1995 forced a delay because of extensive damage to both companies' tracks. A subsequent stock market plunge reinforced the inclination to delay. Moreover, the cost of rebuilding earthquake-damaged lines and a slowing economy caused profits to fall below listing requirements.

At the beginning of the new fiscal year, JR West announced plans to apply for a listing later in 1996. Based on his own privatization experience, the president of JR East urged the other rail lines and the MOT to sell all their shares at one go. One reason for his recommendation was to get out from under the control of the government. This objective was becoming especially important because growing debt at the JNR Settlement was causing the MOF and other government bureaus to consider the passenger rail companies as a source of funds to help liquidate the debt. If the companies were wholly in private hands, the reasoning went, the government could not impose a levy on them (*Kyodo*, 13 May 1996).

In late August 1996, 750,000 shares were offered at auction, but only 675,000 were taken up. Shareholders got a sweetener in the form of coupons for 20 per cent ticket discounts based on the number of shares that were held. Although analysts considered the price to be fair, apparently investors were looking for a bigger bargain (*Asian Wall Street Journal*, 30 August 1996).

One year later it was the turn of the Central Japan Railway Co. (JR Central or JR Tokai), which offered 1.5 million shares (of the total 2.24 million) in October 1997. The issue opened smoothly with the closing price on the first day up 7.2 per cent from the auction price. Apparently, the authorities were learning how to run an initial public offering (IPO).

Meanwhile, according to the original privatization legislation, the JNR Settlement Corp. was slated to go out of business in September 1998. Its pension liabilities, real estate assets and company shares were transferred to an existing government corporation, the Japan Railway Construction Public Corp. (renamed the Japan Railway Construction, Transport and Technology Agency in 2003).

In 1999, a second offering of JR East went on the blocks. At first, the government considered unloading all its remaining 1.5 million shares, but ultimately the fear of market disruption led it to hold back a half-million shares. There were also those in the LDP and the MOF who did not want to give up fully their control over the company. LDP Diet members, in particular, feared that a completely privatized railroad would shut down many unprofitable local lines.

The agency enlisted a foreign brokerage house to participate in the offering; Morgan Stanley Dean Witter co-managed the JR East offering with Nomura Securities. Shares were released on 2 August 1999 at ¥652,000, with 20 per cent sold abroad.

The Diet passed legislation in 2001 authorizing full railroad company privatization, including management decision-making without government approval. At the end of the year, the government still owned 12.5 per cent of JR East, 31.7 per cent of JR West and 39.6 per cent of JR Central, and proclaimed its intention to sell its remaining shares as soon as possible. In June 2002, the government announced pending sales of its stake in JR East, JR West, Japan Tobacco and NTT. The 500,000 shares of JR East still owned by the government were put on the market that month. However, plans for the other companies dragged on, and their sale during fiscal 2002 was finally cancelled fearing destabilization of a weak stock market (*Nikkei*, 18 February 2003).

The finance ministry viewed share sales as a revenue-raising measure, whereas stock market officials worried about the price-reducing effect of releasing so many shares. The holding company also wanted to obtain the best price that it could in order to offset the large amount of debt that remained on its books.

In February 2004, the ritual began again, with the announcement of the imminent sale of the residual JR West shares in government hands. This disposition occurred in April with the government ridding itself of all its JR West holdings.

Early in 2005, the Transport Ministry announced its intention of selling most of its JR Central holdings that year. The railroad holding agency sold 600,000 of its shares in July 2005; JR Central directly purchased the remainder of the holdings in April 2006 in an off-hours stock exchange transaction, which kept the shares off the market and thus did not affect overall prices.

As of early 2007, JR East, JR West and JR Central had been completely sold by the government. None of the other government-owned railroads have been sold. More than ¥4.0 trillion in proceeds were realized in the sales (\$36 billion at contemporary exchange rates).

Dealing with labour

Public sector unions were militant and industrial relations conflictual. Some unions representing public employees were openly Marxist and supported the Communist Party. Others were the backbone of the JSP. The limited autonomy enjoyed by public sector management turned wage setting and labour relations into political affairs. Union militancy caused some public employees to split off into unions that were more cooperative. At the JNR, a breakaway faction established a more cooperative splinter group from the dominant and militant union.

In the wake of a victory over a 1971 management reform plan, the militant union and the even more radical locomotive drivers union exerted their influence throughout the company. Labour discipline began to decline and the practice of falsified allowances, unauthorized time off and idle work proliferated. The JNR management desperately tried to avoid labour conflict (Mochizuki 1993: 185).

When the PCAR looked at the JNR issue, it saw a labour discipline problem as well as a financial problem. After the commission published its basic JNR recommendations in July 1982 intimating privatization and break-up, the militant unions offered to participate in management's reform plan, which included job

reductions, but not break-up. The unions seemed to have believed that LDP and JNR opposition would block splitting the company. In 1986, when the JNR reform plan appeared to be inevitable, the locomotive engineers under its charismatic leader made a complete switch and joined the cooperative unions to sign a labour management document that laid out reform guidelines for labour. Following this dramatic move by his fellow unionist, the militant president pushed a more cooperative line, but it was defeated on the shop floor. The failure of its approach led to disastrous consequences: its membership dropped from 187,000 in June 1985 to 110,000 in November 1986. By April 1988, it represented only 17 per cent of the employees of the JNR successor companies (Mochizuki 1993: 186-7).

Well before privatization occurred in 1987, the JNR had implemented parts of its own reform plans as well as the emergency recommendations of the commission. It had reduced recruitment in 1977 and nearly stopped it after 1982. Attrition allowed the workforce to diminish by 95,000 between 1980 and 1985 (22.6 per cent). As privatization drew near, the JNR, with government support, revised its pension scheme to make early retirement more advantageous if taken sooner rather than later. In addition to the usual severance allowance, the JNR offered a premium, equivalent to 10 months of standard wages, to those who offered to resign by 1986. Funds to cover the extra retirements were raised through the issuance of government-guaranteed bonds. In 1985 and 1986, 101,000 left the company compared with the average attrition rate of 54,000 (Watanabe 1994: 98).

Post-reform labour reductions and efficiency gains

Privatization plans estimated the optimum size of the new JR companies at 183,000 employees, assuming the same level of labour productivity as on the private railroads, adjusted for operational differences. Since the JNR would have an estimated 276,000 employees on the eve of reform, redundancies came to 61,000. Planners figured that 20,000 would accept the early retirement package and that the remaining 41,000 would be transferred to the JNR Settlement Corp., which would help them find new jobs by 1 April, 1990, the mandatory ending date of the placement programme (Watanabe: 1994: 97).

As it turned out, attrition and the sweetened retirement package considerably reduced the need for transfers; the JNR Settlement placed only 7,630. At the conclusion of the placement period, 1,047 were dismissed after refusing to accept the new jobs offered them (Watanabe 1994: 99).

From 1987 on, the railroad system (including JNR Settlement) made a net contribution to government revenues instead of being a drain. Of course, 70 per cent of the old debt had been transferred to the JNR Settlement. Passenger and freight volume reversed their steady decline and grew while fares held steady. Debt repayment proceeded steadily until 1991, when the three main passenger companies bought the *Shinkansen* system from the Shinkansen Holding Corp., which was dissolved. The one major disappointment was the debt of the JNR Settlement Corp., which continued to grow because of its failure to sell land and its delay in selling the shares of the passenger companies. By the time the company

was dissolved, the original ¥25.9 trillion debt had grown to more than ¥28 trillion.

Nippon Telegraph and Telephone Public Corporation privatization

Events leading to privatization

The Japanese government operated telecommunications beginning with the first telegraph lines in 1868, extending the Communications Ministry's monopoly to the telephone service in 1889 on the rationale that it could best expand service to rural areas and preserve security. It managed the transition from manual to automatic exchanges after the 1923 earthquake that destroyed much of the existing network. The Second World War would destroy the system even more thoroughly (Takano 1992: 3).

Under the American Occupation, the Communications Ministry was split into two parts: one for postal services and the other for telecommunications. Prime Minister Shigeru Yoshida wanted to privatize telecommunications, but the communications minister and others opposed this move. They reached a compromise in 1952 whereby the Ministry of Telecommunications became a public corporation, renamed Nippon Telegraph and Telephone Public Corporation (NTT), with a monopoly over domestic telecommunications. The Ministry of Posts became the Ministry of Posts and Telecommunications (MPT) with supervisory responsibility over NTT and a newly created public corporation for international telecommunications, *Kokusai Denshin Denwa* (KDD) (Vogel 1996: 139).

NTT set itself two goals after the war: fully meeting the demand for telephone service and building a national direct-dial network. Barred from increasing rates, the carrier raised more than half its investment funds by requiring subscribers to buy telephone bonds for ¥100,000 (\$278). NTT achieved its two goals by 1978, when it cleared the backlog of orders and completed its national network. However, the manpower required for creating a nationwide infrastructure was no longer necessary; moreover, the automatic systems installed as part of achieving the NTT goal of national direct dialling created large-scale staff redundancies. Nevertheless, the payroll continued to grow, peaking at 329,000 in 1979.

NTT virtually ran itself. MPT had a small supervisory office, but one of its two chiefs was reserved for an NTT official. In 1971, a group of young MPT bureaucrats created several study groups to consider reforms in telecommunications. Their report recommended liberalization of so-called value-added networks in data transmissions and questioned the basic NTT monopoly. The Ministry of International Trade and Industry also actively sought the liberalization of telecommunications, mainly to promote the interests of the electronics and computer industries that it oversaw. In addition, at least five government commissions established after NTT's creation recommended greater flexibility and liberalization, with a 1975 report even mentioning privatization and break-up (Vogel 1996: 142-3).

Three separate technological developments contributed to liberalization pressures: the development and spread of advanced computer-linked terminals; the creation of alternative transmission methods via microwave and satellites; and the growing importance of sophisticated value-added networks combining data processing with communications. The new technologies challenged the economies-of-scale monopoly rationale and demonstrated that a unified system might not be able to keep up with blossoming technology-based demands.

Meanwhile, in the late 1970s, US trade negotiators insisted that Japan open its telecommunications equipment market to foreign suppliers, which meant that the cosy relations within the 'NTT family' of monopoly buyer and favoured suppliers would be disrupted. NTT managers desired greater liberalization in their own realm of operations to meet the new challenges, but also wanted to maintain their monopolies over a narrower band of services.

Liberalization ideas were brewing in the MOF as well. In the late 1970s, a group of officials in the budget bureau, pondering ways to reduce lingering deficits, contemplated privatizing the public corporations. They were ambivalent about Japan Tobacco because it was a big generator of tax revenues and wary of JNR because of its huge debt and militant unions. At the top of their privatization list was NTT because of the potential size of the sale, reinforced by the other reasons for privatization already made by others (Vogel 1996: 151).

Despite a wide range of growing opinion that something should be done about the NTT monopoly, it was not until the 1980s, when the United States began the process of deregulating the telephone service, including breaking up American Telephone & Telegraph, that reform in Japan became a serious policy option. Just before the formation of the second PCAR, two separate reports recommended liberalizing value-added networks and competition in basic telephone services. What was significant is that one of these reports came from within the MPT, which suggested reforming NTT management and privatization.

One more event was propitious for reform. In January 1981, just before the official formation of the PCAR, the government dismissed the NTT president. Among the reasons was his involvement in a scandal concerning payments for phoney overtime work – a method to reward employees which seemed to get around the law that required salaries to be equal to those at JNR. The new president, Hisashi Shinto, was the first outsider to take command of the company. He had a reputation as a rationalizer and cost-cutter as head of Ishikawajima Harima Heavy Industries, where he had succeeded Toshio Doko, who had gone on to chair the PCAR. It was said that Doko personally selected Mr Shinto for the NTT job (Vogel 1996: 152).

Shinto quickly saw that the NTT required drastic overhaul; he appointed a group of mid-level managers to review the possibilities. They came up with three alternatives: transforming NTT into a completely privatized company; becoming a special private company similar to Japan Airlines with both private and government ownership; and remaining a public corporation, but with greater autonomy and flexibility in structure and business operations (Takano 1992: 6).

NTT suppliers vigorously fought privatization. In addition to their self-serving interest in preserving a guaranteed market, they also valued the collection of technical talent, network coherence, focused resources and regulatory knowledge. Since the suppliers were staffed at high levels with former NTT officials, the feeling was even stronger that past structures should not be altered. However, they were sensitive to the charge that American negotiators could use active campaigning against reform as evidence of barring foreign manufacturers from the Japanese market.

The reform commission reached a consensus on NTT by May 1982. As background to privatization, it noted the necessity of restoring government finances and pointed to innovations in telecommunications technology. It concluded that privatization was necessary, competition should be established to eliminate the negative effects of monopoly, and that the limits of managing such a huge organization should be taken into account in rationalizing the corporation's scale. The last observation pointed to reorganizing NTT into geographical entities, perhaps linked through a central organization (Takano 1992: 6).

With the reform commission report in hand, LDP Diet members worked to find a way to implement the suggestions in a way that would satisfy the bulk of their constituents. The LDP, NTT suppliers, some parts of NTT management and the labour unions agreed to privatization, but break-up continued to be unacceptable.

Unions at NTT were more cohesive than at JNR; a single union represented all employees. In the early 1960s, it had purged Communists from its ranks. NTT executives stressed good labour relations because of the need for flexibility to respond to the rapid pace of technological change in the industry. Unlike their counterparts at the railroads, they did not engage in union-busting activities. The union, in exchange for its cooperation, persuaded management not to dismiss employees or reduce the workforce. By the 1980s, the telecommunications workers had the shortest working week in the public sector at 37 hours. Although the company's monopoly status allowed it to be profitable, an independent audit revealed 100,000 redundant employees. Reviewing these figures, the administrative reform commission was concerned that NTT would not be able to compete against foreign companies as the sector became more internationalized (Mochizuki 1993: 192).

The union's chief concern was that break-up implied more competition, which would impose job loss, keener competition among suppliers (possibly from foreign companies) and the loss of political influence. The union was concerned also that break-up would fragment it into separate enterprise unions.

Although the union adamantly opposed change, soon after the release of the PCAR's July 1982 report recommending both privatization and break-up, the union shifted gears to embrace privatization. It hoped to escape the wage restrictions that kept it locked into the same pay scales as the railroad workers. The union leader decided to cooperate with the reform movement to secure the best possible outcome for his workers. Abandoning its ties with the JSP because of its ineffectiveness in the Diet, the union approached the LDP. The union was

concerned that privatization would remove many of its protections written into law, such as proscriptions against layoffs and wage cuts. Since the break-up was opposed by most of the interested parties, the union was able to attain most of its objectives (Mochizuki 1993: 194-5).

Within the ruling political party, the tactical job of dealing with the LDP conservative wing that opposed liberalization and break-up went to a senior member of the main LDP faction, Shin Kanemaru. In July 1983, he proposed a solution put forth by NTT that called for minor changes to its status as a public corporation. The conservatives readily accepted his proposal; however, the finance ministry and LDP leadership roundly condemned it, an outcome that did not surprise its author because the proposal was designed to fail. Kanemaru then went back to the NTT supporters in the LDP and told them that he had done his best and they had best throw their support behind a more radical approach. NTT head Shinto and reform commission members also helped to lobby the recalcitrant LDP members. MOF officials, anxious to get their hands on the privatization money, joined in.

Prime Minister Nakasone next recruited Ryutaro Hashimoto, a prominent LDP politician, to find consensus in August 1983. Hashimoto submitted a report that endorsed the reform commission on privatization and competition, but that did not clearly call for break-up, stating such a possibility should be reconsidered in 10 years (Takano 1992: 10).

The core struggle then settled on the different policy goals of NTT along with its main union and the MPT. The telephone company understood that a basic shift was under way where it required greater business flexibility to play in a more competitive and fluid environment. The MPT, however, viewed the situation as a continuing political struggle with MITI and NTT, and therefore sought greater authority over its industry (Vogel 1996:156).

The Diet passed three telecommunications laws in December 1984; the MPT achieved many of its goals as the compromises worked out in the legislative process tended to swing in its favour. One point that it lost concerned the revenues from privatization, which it wanted devoted to research and development. The MOF agreed to share one-third of the revenues with MPT and MITI for a new R&D facility. The remainder would be reserved for deficit reduction.

Selling and restructuring NTT

Mr Hashimoto's negotiations with the various interests indicated that legislation could not be passed if break-up was written into the law; instead, it called for a review of the issue in five years. On 1 April 1985, the new corporation was created with the issue of 15.6 million shares. The NTT privatization law required that the government retain at least one-third of the total shares, a fraction that would give it blocking authority in corporate decisions. The MOF and MPT agreed that government-owned shares should be higher than the minimum – above 50 per cent, at least within the five-year period of legislatively mandated stability. Therefore, the maximum number of shares that would be sold by 1990 would be 7.8 million.

Implementation of this plan called for selling 1.95 million shares in four lots in each fiscal year starting in 1986 (Takano 1992: 27).

The Finance Ministry decided to establish a market price through competitive public bidding. Since a political goal was widespread ownership, the auction was combined with a public offering. Before the NTT listing, the largest equity issue ever placed in Japan was for ¥144 billion by Tokyo Electric Power Co. in 1981. The MOF analysts projected ¥416 billion from the NTT sale at an estimated price of ¥213,210, almost three times the previous largest sale; some private estimates projected the price at closer to a million yen.

The first auction, of October 1986, put the weighted average price, and the one set for the public offering, at ¥1,197,000. The lowest bid was five times the MOF estimate and the public offering was overbid by nine times. The total came to a staggering ¥2.4 trillion (\$15.3 billion).

The price of NTT took off after the listing, caught up in the frenzy that was gripping Japanese stocks as a whole. The price hit a high of ¥3.18 million in April 1987. With this response to motivate them, the authorities scheduled the next tranche for November 1987. The selling price of ¥2.55 million was considerably below the peak price, but substantially above that of the first sale. The MOF realized almost ¥5 trillion.

Although the stock market bubble would continue for another year, NTT was already on its way down at the time of the second release. For the third offering in 1988, the government reduced the number of shares to 1.5 million because of fears about the market's absorptive capacity. The planned fourth placement was postponed. The government continued to hold almost two-thirds of the company going into the 1990s (Takano 1992: 33-4).

With privatization in process, NTT's no-layoff agreement with the unions meant that reducing the number of redundant workers had to take place by attrition. NTT had almost 304,000 workers at the time of privatization in 1985, which dropped to 266,000 five years later.

The five-year postponement of a decision on NTT's structure came up for decision, but in 1990 the future of the company was deferred for another five years. The finance minister announced in August 1992 that there would be no further sales until after March 1994, although he said that he hoped to resume sales as soon as market conditions improved (*Wall Street Journal*, 25 August 1992).

In 1995, two advisory commissions recommended breaking up the company into a long-distance firm and two regional ones. By this time, Mr Hashimoto had become prime minister. All the parties who opposed break-up in 1985 continued their opposition, and it was taken off the table. MPT – perhaps to counter the continuing looming presence of an unreconstructed NTT – accelerated telecommunications deregulation measures.

Before the government offered additional shares of NTT to the market, the company decided to list one of its subsidiaries, NTT Data Communications Systems Corp., to raise funds for investment. NTT Data listed on the second section of the TSE in April 1995 as NTT offered 47,000 shares of its holdings of 200,000. NTT, not the government, raised ¥49 billion (\$575 million).

In the 1990s, evidence was growing that Japan was falling further behind other advanced countries in telecommunications services. For example, foreign companies were making important inroads in Internet services in Japan. Moreover, the American government continued to press Tokyo to free up its telecommunications market and to increase NTT purchases from US suppliers. Despite the international pressure, it was still a surprise when NTT and MPT announced plans in December 1996 to restructure the firm into four parts – two regional carriers, a long-distance company and a holding company of the three operating companies. Owners of NTT shares would exchange them for shares in the holding company. At the same time, KDD would be permitted to enter the domestic market and NTT could venture into international business. The immediate stimulus for NTT's agreement to this arrangement after more than 10 years of obstruction was the wave of global mergers and partnerships occurring in telecommunications; the giant new foreign firms created in this process were entering the Japanese market.

The Diet passed amendments to the telecommunications laws in June 1997 enabling the agreement to be implemented. The company set up the new structure on 1 July 1999.

In the midst of the restructuring debate, the stock market had improved sufficiently that the MOF announced plans to sell 500,000 NTT shares in the 1997 fiscal year. The price of NTT shares, which had fallen as low as ¥450,000 in 1992, had doubled by May 1997. The imminent passage by the Diet of the NTT restructuring legislation cleared the outlook for the firm and removed uncertainty from that front. However, towards the end of the fiscal year, the sale was abandoned to avoid overloading the market. The MOF budget planners suggested that a million shares might be put on the market in the next fiscal year because the government's budgeting depended on proceeds from NTT share sales (*Kyodo*, 21 March 1998).

Despite MOF hesitancy, NTT announced plans less than a month later to sell additional shares in NTT Data in what was being touted as the largest offering of new shares since 1993. The company raised ¥150 billion on the issue date of 11 May 1998; the equity sale allowed NTT to avoid increasing its interest-bearing debt, to which it was becoming more sensitive.

The MOF screwed up its nerve the following October to go forward with the fourth tranche of NTT's share sale. However, ministry officials still hedged their bets by saying that they would determine the timing of the offering only after studying the market situation. Several foreign firms joined the team to manage the offering (*Wall Street Journal*, 2 October 1998).

Again, though, NTT beat the ministry to the punch with the largest IPO in Japan's history. At the time that the MOF announced its tentative plans to float more of NTT, the firm was in the process of selling its mobile phone subsidiary NTT DoCoMo, with a listing in October 1998. Goldman Sachs International and Nikko Securities were the global coordinators for the 545,000-share sale, some 18 per cent of which the underwriters allocated to the foreign market. The offer brought NTT's stake down to 67 per cent from 95 per cent. The ¥3.9 billion price raised ¥2,126 billion, which although smaller than the second and third NTT

tranches met expectations as the largest IPO. Within days of the listing, NTT DoCoMo surged 20 per cent higher (*Wall Street Journal*, 12 October 1998).

Buoyed by the success of the DoCoMo launch, the MOF proceeded with its fourth NTT sale on 15 December 1998, ending the 10-year drought of NTT shares. The sale brought the government's holdings down to 59 per cent. A new twist was that about 40 per cent of the shares had been set aside for foreign distribution, a change from the past when foreigners were barred from holding NTT shares. The World Trade Organization's telecommunications trade pact that had taken effect the previous February forced Japan to end foreign ownership restrictions on common carriers or so-called Type I firms – businesses that use their own circuits to provide services. (However, the 20 per cent cap on foreign ownership of NTT and KDD remained in place for the time being.) As the subscription unfolded, demand from individual domestic bidders poured in and the government dictated that individuals should receive at least one share, which pushed the foreign allocation down to 30 per cent of the offering.

In the year following the fourth tranche, NTT shares almost doubled in price. When the MOF decided the following October to set the next sale, the price was over ¥1.3 million, 50 per cent higher than the previous December. The prospectus listed 952,000 shares for sale, which would bring the government's stake in the company to about 53 per cent. The offering was one of the five largest of the 1990s and among the top 10 of all time (*Financial Times*, 9 November 1999).

In the midst of a June 2000 political campaign, Prime Minister Yoshiro Mori indicated that he thought that NTT should be completely privatized. Government ownership and control kept the company from making full use of its resources, the prime minister said. His comments suggested that the Japanese government was considering revising the law to allow the sale of its entire shareholding in NTT. Other voices suggested that the industry was changing so fast that the company's structure and continued regulation no longer made much sense (*Financial Times*, 12 June 2000).

A few months later, NTT managers petitioned the government to liberalize the rules under which it operated. In particular, it sought relaxation of the government's one-third stake requirement, restrictions on foreign ownership and the issue of new shares that hindered its expansion. It suggested that it might want to issue new shares in its own name to raise funds for acquisitions and other purposes. Although the telephone company retained a credit rating higher than the government's, it preferred equity financing to borrowing to keep its balance sheet under control. Issuing new shares, of course, would compete with MOF sales in the market (*Financial Times*, 29 September 2000).

While NTT was petitioning the government, the MOF was in the process of organizing the next sale. It sold 1.2 million shares in October 2000. Two weeks later it placed another 100,000 shares entirely to foreign buyers that had been set aside to fill any over-allotment.

As the Japanese government's debt continued to grow, the MOF had already included the proceeds from the next projected sale in its fiscal 2001 budget. However, LDP Diet members began to question the wisdom of further sales in a weak

market, especially one in which telecommunications stocks were hard hit around the world. A planned release of DoCoMo added further caution to MOF plans.

Specialists at the MOF were pondering other means to complete the privatization without unduly upsetting markets. They sought greater flexibility in the timing and volume of sales. For example, they were reviewing the possibility of using exchangeable or convertible bonds, which could later be turned in for equity. Another idea was to dribble out shares in small amounts; however, this scheme might depress prices because investors would not be sure about pending releases that could affect future prices. Some industry analysts complained that the ministry was not willing to consider the key to greater investor enthusiasm: breaking up the company. Analysts noted that the returns generated by NTT were less than the company's cost of capital. Until this situation was improved, investors were unlikely to be wild about new shares (*Financial Times*, 23 January 2001).

Despite annual announcements of million-share sales, the government subsequently conducted no further transactions of NTT on the open market. However, the company – concerned about the low returns experienced by its investors – used its large cash reserves to buy back shares held by the public – including 92,000 shares held by the Finance Ministry in 2002 and 85,000 the following year. This method of reducing the government's holdings was repeated in 2004, when the company bought 800,000 shares in an off-market transaction. These sales reduced the government's holdings to 40.8 per cent of outstanding shares. NTT purchased the final 1.12 million available shares in September 2005, bringing the government's holdings down to the legally mandated one-third of outstanding shares. Any further privatization would require change in the law.

In fact, an April 2006 study group of the Internal Affairs and Communications Ministry, the successor agency to the Ministry of Posts and Telecommunications, urged scrapping the requirement for government ownership. The minister, Heizo Takenaka, had been appointed to that post by Prime Minister Koizumi to implement post office privatization. As a former economics professor with no interest group attachments, he had already dealt with banking as director of the Financial Services Agency. The LDP's subcommittee on telecommunications urged that any changes to the NTT law be delayed for study until around 2010. Thus, it appears that the battle over the future of government involvement in NTT will continue for many years.

Japan Tobacco

Tobacco and salt monopoly

France and Austria established tobacco monopolies in the 1670s to raise revenues. Japan and Sweden did so in the twentieth century. Tobacco was not subject to taxation in Japan until 1876, when the government imposed a general business tax. It remained in operation until 1898, at a time when Japan was burdened with the costs of the 1894–95 war with China. The business tax was abandoned and the government established a state monopoly for the purchase and resale of Japanese

tobacco leaf. The monopoly was extended to foreign leaf in 1900. The final step in the direction of complete state monopoly over purchase, manufacture and sale was taken in the law passed in April 1904, when the need for increased revenues had again become imperative because of the Russian war.

Bureaucrats knowledgeable about French achievements established the Japanese tobacco manufacturing monopoly. The Monopoly Bureau of the MOF recruited engineering and law graduates from the top Imperial universities; the head of the bureau in 1912, Osachi Hamaguchi, was a graduate of Tokyo University and a future prime minister of Japan. Within several years, the bureau had substantially raised prices and revenues, concentrated its output in large factories and nearly doubled the productivity level that had been achieved under private management. By 1912, productivity in Japan's tobacco industry was estimated at half the American level, whereas average productivity in Japan was only 10 per cent of the US (Hannah 2005: 31-3).

The 80-year-old Japan Tobacco and Salt Public Corporation (formerly known as the Japan Monopoly Corp.) was privatized as the Japan Tobacco Industry Co. (JT) on 1 April 1985. The privatization law required that the government hold at least half of all shares, but additional clauses raised that limit to two-thirds; there were no immediate plans in 1985 to sell the permissible one-third government stake.

The law was considered a defeat for the cause of administrative reform. Political pressures were able to divert the reform movement and produce a major victory for the agricultural interests of the LDP and the 90,000 or so tobacco growers concentrated in the southern island of Kyushu, who vigorously opposed privatization. The farmers were joined in opposition by elements in the MOF who expected to find jobs in the tobacco company after retirement from their government careers (*Australian Financial Review*, 1986). As the monopoly producer and seller of tobacco products and salt in Japan, the company had been obliged to buy all leaf tobacco produced in the country at fixed prices, typically about three to four times world levels. Under the new arrangements, this scheme was retained. Moreover, the company's monopoly over tobacco product manufacturing continued after privatization.

The old regime limited foreign sales to 10,000 retail outlets out of the 260,000 licensed to sell tobacco products. In addition, importers' advertisements were restricted to English-language media; the foreign companies were required to pay a 15 per cent excise tax within 30 days of sales on top of a 24 per cent tariff while the JT had a six-month tax payment grace period. Foreign products held a scant 2 per cent market share in 1984 (*Financial Times*, 4 April 1984).

Negotiations with the US government had already expanded the number of outlets to 70,000 in 1984. The privatization law allowed foreign brands in all licensed outlets. Immediately after the law passed the Diet with its promise of competition from foreigners, the newly minted company announced cuts in the number of offices and staff (*Financial Times*, 24 August 1984).

In 1986, after further negotiations, the Japanese government agreed to eliminate the 24 per cent tariff on tobacco products in exchange for the United States

dropping charges of unfair trade practices. By mid-1987, foreign brands were selling at the same price as domestic ones and the foreign market share had jumped to 8 per cent.

Selling the government's shares

Towards the end of 1991, the MOF announced plans to sell one-third of its JT shares in fiscal 1992. Apparently, ministry bureaucrats had been planning such a move for some time, but hesitated because of the collapsing stock market. Falling tax revenues, however, shifted the balance of considerations. Although the sale was expected to encounter little difficulty, MOF officials noted strong opposition from tobacco growers, who were concerned about the influx of private capital into tobacco operations.

The sale never occurred and little more was heard until May 1993, when a MOF advisory panel met on the subject for the first time in a year. An official confirmed that it was considering a sale 'some time this year' while monitoring the market reaction to a sale of JR East. As autumn approached, the date was set back to early 1994. By this time, foreigners controlled 20 per cent of the market. JT had reduced the number of its wholesale outlets by 36 per cent to 174 and had cut staff levels by 20 per cent. Although bank debt, at less than 1 per cent of total assets, was lower than in the railroad companies, the JT management wanted to diversify in the face of a declining overall market, growing foreign competition and its own high costs dictated by the requirement to buy domestic output at artificially high prices. The company wanted to be able to raise capital to fund diversification (*Financial Times*, 10 September 1993).

Early 1994 came and went without further mention of a sale. Finally, an announcement came in July of a two-stage offering: 230,000 shares would be sold at auction in August and the remaining 436,660 shares would be distributed through a lottery when the shares were listed in October 1994 at the average weighted auction price. Anticipating the cost-cutting demands of future shareholders, the company had closed six of its 32 factories since 1985, and by 1994 had further trimmed staff by 32 per cent of the 1985 level. These cost reductions enabled JT to remain marginally profitable (*Far Eastern Economic Review*, 4 August 1994).

Recalling the wild ups and downs of NTT share prices in the months after it was first listed, JT officials and the Japan Securities Dealers Association recommended a price limit on the first trading day to hold down soaring prices 'as a result of excessively heated demand' (*Kyodo* 20 April 1994). In contrast, analysts at non-Japanese brokerage houses were less enthusiastic, mentioning that the company was losing its share in a declining market, JT's diversification ventures were all losing money, exports were minimal and high production costs were mandated by law (*Asian Wall Street Journal*, 12 July 1994).

As the August auction progressed, the average auction price came in at ¥1.4 million. Individuals accounted for an estimated 80 per cent of the bids, with some going over ¥2 million. By most measures, the JT was more overvalued than

previously listed government issues, which made the feared initial price surge improbable (*Asian Wall Street Journal*, 1 September 1994).

The denouement occurred in mid-October when the MOF announced that two-thirds of the lottery winners had withdrawn their earlier application. Even those who agreed to accept their lottery shares were not a happy crowd. On listing day, the market opening of the company was delayed until the afternoon as 30,000 sell orders overwhelmed 5,000 buy orders. JT closed the day at a 24 per cent discount from the auction price. The company's market price did not approach the auction day level for another five years. MOF officials said that the unsold shares would probably be offered in the next fiscal year, but this was delayed until 1996.

The authorities tried to learn some lessons from the 1994 fiasco for the next sale. They invited foreign firms to apply as underwriters and reserved some shares for foreign investors. They also used a book-building method to determine an appropriate offering price. Nomura Securities and the London arm of Goldman Sachs were chosen to lead the underwriting for the June 1996 transaction.

Because of the legal requirement that the government hold two-thirds of JT shares, the company could not issue new shares on its own or make use of equity swaps in its diversification goal. In order to finance transactions, the company was forced to accumulate cash reserves, borrow the funds or sell bonds in the capital market. It did all three, but not without complaints from stockholders. In 1997, the company held ¥650 billion in cash and short-term instruments. Shareholders called for distributing it in dividends or stock buybacks.

The financing requirements of acquisitions came to the fore in 1999 when JT bought the international tobacco business of RJR Nabisco Holdings for \$7.8 billion. The company arranged the largest ever syndicated loan in Asia, a \$5 billion, 364-day facility. The company planned to pay back the loan within six months through a capital market issue. In the months following the deal, the price of the company's shares hit an all-time high, which eased raising capital through dollar and yen bonds as well as loans. This experience convinced management that the company needed greater financial flexibility to implement the diversification plan required to cope with a declining market in tobacco products. The only way to do this was to reduce or eliminate the government's mandated stake in the company. The same idea occurred to government officials and politicians, but for different reasons. They saw the government's shares in JT and the other partially privatized companies as potential revenue sources, especially as deficits widened in the 1990s.

A bill was introduced in the Diet in December 2001 that would allow the MOF to divest itself of its entire JT holdings and allow management to issue new shares, but limit the maximum additional shares to one million. At the same time, JT would continue to exercise its monopoly rights over domestic manufacturing as well as its responsibilities to take up the domestic tobacco crop.

Former MOF personnel dominated JT's top management. Although they recognized certain market imperatives, they also sought to protect the traditional interests of farmers, retailers and their former ministry colleagues expecting post-retirement jobs. It was only in 2000 that a CEO took over who had risen through

the ranks and was not a MOF bureaucrat. He reiterated the company's preference for full privatization to a MOF advisory group in 2001. A MOF official said in reply that three issues – the requirement to purchase all domestically produced tobacco leaves, JT's manufacturing monopoly and shareholding rules – were closely related (*Nikkei*, 5 March 2001).

Despite JT's preference for full privatization, a view that was shared by a few Diet members and government staff, the Finance Ministry's advisory council recommended only that the government's share be allowed to fall to 50 per cent. If the company issued new shares, the government's holding could then be decreased to a minimum one-third of all issued shares. The Diet passed a law with these limits, which became effective in April 2002 (*Kyodo*, 7 December 2001).

Eight years after the previous sale, the Japanese government released 14 per cent of its JT stake in June 2004, generating ¥241 billion for the national treasury. This reduction of government holdings brought its share down to the legal minimum of 50 per cent of originally issued shares.

Post-privatization performance

The principal resistance to further privatization came from the tobacco farmers and their LDP supporters. Under the law, and especially as long as the government holds a controlling interest in the company, it can compel its purchase of the total Japanese tobacco crop. Privatization had been orchestrated to allow this practice to continue.

However, this constituency is in secular decline. From about 100,000 tobacco farmers in the early 1980s, the number declined steadily to 18,000 in 2005. Moreover, in order to reduce the cost of its required purchases, JT in August 2004 offered farm households a payment to quit farming. JT paid ¥4.2 billion to 4,000 tobacco growers; the number of families involved in tobacco growing is expected to fall to 14,000 by 2008.

Production fell by two-thirds from the 1980s to 2005. In 1999, the area devoted to tobacco fell below 25,000 hectares for the first time. A gentlemen's agreement between JT and the farmers had committed the company to set prices that would keep this area under cultivation. However, the cultivated area fell to 21,000 hectares by 2005. The age distribution of the farmers is growing older at a fast pace, with the majority of them over 65 years and few new ones taking the place of those who leave agriculture. By 2003, almost half of unmanufactured tobacco was imported and 27 per cent of the cigarettes sold in the country came from abroad (US Department of Agriculture 2004: 7, 12).

JT managed to remain profitable in the face of declining demand and growing foreign competition, except for 2004, when restructuring costs helped produce a loss. With the cigarette market in long-term decline, JT announced a major restructuring plan in 1999 to eliminate 4,500 jobs (14 per cent of the payroll) and reduce its 20-plus processing plants to 10 within five years. It emphasized diversification into a broad range of new businesses, particularly tobacco machinery, food processing and biotech. By 2005, all segments earned positive profits.

Imports have been the driving force for improved efficiency. Competition forced attention to costs, which promoted a search for greater efficiency within JT and convinced farmers that both foreign leaf and imported manufactured cigarettes were threats. Remarkably, in 2005 the company's return on its assets (operating income plus financial income to total assets) was a healthy 9.3 per cent (Japan Tobacco 2005: 99).

Japan Airlines privatization and deregulation

Post-war law and regulation

The basic framework for Japan's aviation industry was established by the 1952 Civil Aeronautics Law, which gave MOT the mandate to set routes and fares and approve operators. The Japan Airlines Co., Ltd (JAL) had been formed the year before. In 1953, the government became the airline's controlling owner by putting up half its capital. JAL entered international markets in 1954 as Japan's 'flag carrier', the term used at that time to denote a country's designated international airline. Although JAL had a monopoly on overseas routes, several companies competed in the small and chaotic domestic market of the early post-war period. Two of them merged in 1957 to form All Nippon Airways Co., Ltd (ANA).

A 1970 cabinet resolution brought the industry under the heavy regulatory hand of the MOT, which implemented the policy in 1972. The so-called 1970-72 system, also referred to as the 'aviation constitution', created a segmented industrial structure built around three companies - JAL, ANA and Toa Domestic Airline Co. Ltd (TDA) - the last formed under official guidance through the merger of two smaller carriers. The government assigned JAL responsibility for international service and a few domestic trunk routes - connecting Tokyo, Osaka, Sapporo and Fukuoka. ANA was given domestic trunk routes, local routes and some short-haul international charter flights. The TDA, which merged with several other small carriers to form Japan Air System Co., Ltd in the 1980s, received local routes and a portion of the domestic trunks. Competition among the three carriers was almost non-existent.

Near monopolies on most routes as well as regulated fares allowed the MOT to assign unprofitable flights serving outlying islands or small towns to ANA and JAS. The earnings from high-density routes subsidized this far-flung network, parts of which had been established under pressure from influential Diet members looking after their constituents' interests.

The 1970-72 system was internally consistent. It allowed the three airlines to earn sufficient profits from the larger domestic and international centres to cross-subsidize other locales. The absence of competition on prices and routes plus official barriers to entry of new carriers guaranteed a relatively quiet life for the companies. It also brought high fares based on costs that grew increasingly out of line with those of deregulated airlines in the United States and elsewhere.

Competition stirs up domestic and international markets

Following the late 1970s' deregulation of airline operations in the United States, the American government turned its attention to the international system's cartelized market structure and government price supports. In negotiations over bilateral pacts, the mechanism that governed international aviation relations among most countries, Washington sought more liberal entry and pricing arrangements. Its eventual aim was deregulated international 'open skies'. Japan was an early target of American negotiators because its 6 per cent shares of total US international passenger traffic seemed small relative to the potential market that might arise under liberalized fares and routes.

Japan's aviation policymakers hoped to introduce such reforms as might be desirable at a pace that would allow domestic participants time to adjust to new economic forces created under a freer regulatory regime. Ministry planners expected implementation to last decades. Before this policy could be articulated very clearly, however, a sharp increase in the demand for international cargo flights and the introduction of Boeing Co.'s wide-body 747 aircraft made lower-cost freight traffic technically and economically feasible. The MOT opened a small crack in Japan's segmented market structure in 1983 when it granted a licence to Nippon Cargo Airlines Co. Ltd (NCA), a venture formed by ANA and six Japanese shipping companies. The appearance of NCA as a competitor to JAL on international cargo routes was the first challenge to the old system.

The crack widened further in 1985 when the United States and Japan began a new round of negotiations over transpacific rights. The agreement that emerged was based on the principle of 'balanced expansion'. It allowed three new carriers from each country to launch services across the Pacific. To forgo this opportunity would have left Japan faced with a dominant American presence in the all-important US-Japan market. Moreover, by this time, Japan had signed aviation agreements with Australia, France, Great Britain and other countries that also allowed more than one Japanese carrier to serve those markets.

The logic of the 1970-72 system made it impractical for Tokyo to open the international market to new entrants and still keep the domestic market tightly regulated. JAL would face stepped-up competition and probably declining revenues and profits without the opportunity to make up the difference elsewhere. Moreover, ANA was losing money on some 70 per cent of its domestic flights. New competition on its major, profitable routes would jeopardize the carrier's financial survival.

Unsure of how to handle these issues, the MOT asked a transportation advisory council in September 1985 to review three issues: allowing domestic carriers onto international routes, privatizing JAL and introducing competition in aviation. In October, the aviation policy committee of the LDP recommended that domestic carriers be given international rights and that JAL be privatized. The MOT council recommended multiple carriers on international routes, new entrants on routes serving domestic city pairs (as warranted by traffic volume) and the privatization of JAL.

The advisory council advocated a framework of 'double and triple tracking', two or three carriers servicing a particular route based on passenger volume. The MOT implemented this suggestion by declaring that two airlines would be allowed on routes with at least 700,000 passengers a year and three carriers would service routes with more than 1 million passengers annually. For the first time, JAL, ANA and JAS faced competition on their most important routes. In return, however, they were permitted into market segments formerly denied them.

In its measured way of promoting a more competitive industry, the MOT lowered the hurdles for double and triple tracking in 1992 to 400,000 and 700,000 passengers a year respectively. In 1996, they were cut further to 200,000 and 350,000. Taking advantage of the new opportunities, by 1990 ANA controlled 10 per cent of Japan's international passenger traffic, doubling that share to 20 per cent in 1997. JAL did the same in the domestic market, quickly capturing 20 per cent of in-country traffic

Selling JAL's shares

As a capital-intensive company, JAL required financing for aircraft acquisition. In the 1970s, it raised capital through bond sales in Japan, the United States, and Europe. Dollar borrowing was used to pay for the aircraft it bought from the American manufacturer, Boeing. The company indirectly increased its capital base in 1979 by issuing convertible bonds, which could be converted to shares over the next several years. Since the share price was rising over this period, most of these bonds were profitably converted.

By 1980, the government's original 50 per cent share of JAL had been diluted to 41 per cent through conversion of the convertible bonds. Several months before the Diet's December 1980 authorization of the second PCAR, Administrative Management Agency director Nakasone threw some thunderbolts at JAL and the transportation ministry by proposing that the government sell its remaining holdings in JAL and the Electric Power Development Corp. His rationale was twofold: to use the income from the sales to reduce new government bond issues, and to bring more profit-oriented management to the public corporations (*Nikkei*, 23 September 1980). It was estimated that the sale of JAL shares could realize ¥25.5 billion (\$120 million).

The MOT held serious reservations about the idea of selling JAL shares. If its holdings fell below one-third, it would lose control of the still-regulated company. Furthermore, the MOT wanted to be guaranteed priority rights to subscribe to any new shares that the company subsequently might offer (*Nikkei*, 16 December 1980). After cabinet discussion, the government agreed to sell 5 per cent of its stake in the company (2 per cent of all shares). The MOT agreed to this sale since it would preserve its controlling interest in JAL.

At the same time, JAL embarked on an ambitious equipment programme. Planning to spend \$2.4 billion over the next four years, the company projected the need for at least 1 billion dollars of financing. It had already gone to the Eurobond market seven times and was hoping to attract equity investors. However, for that

to be a feasible option, the government share in the company would have to come down. The tripling of its share price over the past year gave a strong motivation for the government to raise cash from share sales (*Euromoney*, September 1985).

While deregulation discussions were proceeding, JAL experienced the worst air disaster in history when a Boeing 747 crashed soon after takeoff on 12 August 1985 with the loss of 520 lives. When top JAL executives resigned, Prime Minister Nakasone personally appointed a new president and chairman. Observers likened this move to the sacking of the president of JNR when he objected to the pace and scale of privatization earlier that year.

The new JAL president had worked on privatization issues in the Administrative Management Agency under Nakasone. He noted that the company's vitality had been sapped by government intervention. He also suggested that government backing had led to militancy among JAL's non-unionized pilots and four rival employee unions. The government was always there, he said, to bail out the company if overstaffing, excessive wages or rigid work rules increased costs (*Far Eastern Economic Review*, 16 January 1986).

With new leadership at the airline and with the ministry's advisory council's report in hand, the MOT formally adopted the council's recommendations in May 1986, planning to sell its portion of the company gradually over several years. However, by early 1987, the Finance Ministry was suggesting that JAL shares should be sold by the autumn of that year, if not earlier. Enthusiastic investor support of the first NTT sale, plus JAL's zooming stock price, seemed to warrant a quick disposal.

In anticipation of privatization, the airline was forced to consider its efficiency: 1,100 ground personnel were reassigned to subsidiaries and the company proposed a reduction in crew size to increase efficiency. For example, the carrier flew the Los Angeles-Tokyo route with 23 cockpit and cabin crew compared with 16 on Northwest Airlines or 17 on United Airlines' longer Tokyo-New York flight (*Business Week*, 31 August 1987).

In September 1987, the Diet passed the JAL privatization law requiring that all the government's shares be sold by the end of the year. The Finance Ministry set the sale for 15 December. About half of the government's 34.5 per cent stake in the company was already allocated to stable shareholders such as JAL affiliates and subsidiaries, its banks and institutional investors (*Kyodo News*, 24 November 1987).

Life after privatization and deregulation

Perhaps the best indicator of the effect of JAL privatization and industry deregulation on performance is the behaviour of prices and costs. Figure 10.1 shows domestic yields (yen revenue per passenger kilometre) adjusted for price changes by the consumer price index, for both ANA and JAL. The trend is downwards for almost the entire period since 1980. The jump in JAL yields after 2001 was caused by its takeover of Japan Air System Co., whose shorter routes imposed higher costs. Although the introduction of greater domestic competition did not

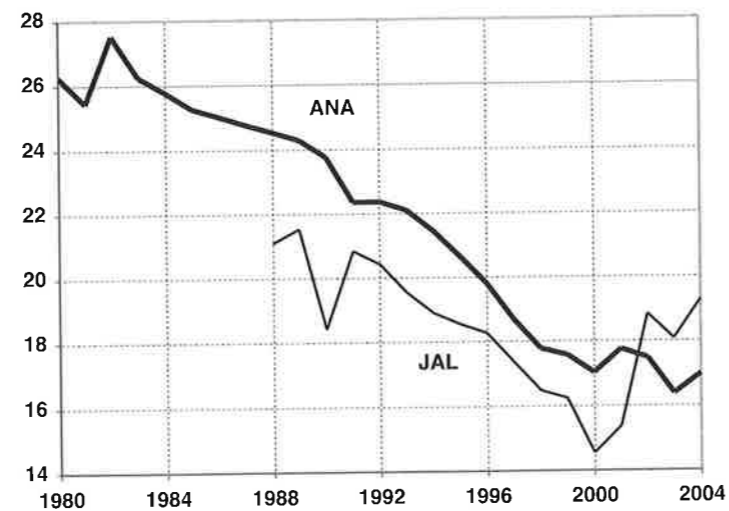


Figure 10.1 Domestic passenger yields on Japanese airlines (2000 ¥ revenue per passenger kilometre). Source: company annual reports.

noticeably accelerate the reduction in yields, the steady improvement over 25 years may not have been so persistent without the introduction of several carriers on most routes. On international routes, the Japanese airlines have to compete with some of the most efficient in the world. Both Japanese companies struggled to bring their costs and prices down to meet the challenge of international competition. By 1998, yields for the Japanese companies had finally converged to those of the American carriers.

The evidence suggests that privatization, and especially deregulation and competition, have had the desired effects. Efficiency has risen and prices have fallen. JAL management is acutely sensitive to profitability considerations. New entrants have driven down prices on the most popular trunk routes. Although constrained by geography and airport limitations, Japanese aviation is approaching international standards. Still, it has taken more than 20 years for the Nakasone vision to be realized in this very Japanese example of privatization and deregulation.

Conclusions: privatization with Japanese characteristics

More than a quarter-century after the privatization process of Japan's state-owned companies began, the government had disposed completely of four: JAL, JR East, JR West and JR Central. It still owned 33 per cent of NTT and half of JT. In addition, the government continued to hold all of the shares of the three smaller island railroads and a freight line. Table 10.1 gives the full sequence of share sales.

The sales generated proceeds of ¥20.6 trillion (\$167.5 billion) for the government. The Finance Ministry estimated total financial gains at ¥31 trillion for the 10 years from 1985 to 2004, an amount that included sales proceeds, dividends and taxes paid by the privatized companies (*Nikkei*, 3 September 2005).

Perhaps the main conclusion of this review is how difficult it is to accomplish even such broadly accepted and justifiable policies. It required the abundant political skills of Mr Nakasone, both when he was an agency director and as prime minister, to proceed as fast and as far as he did. Opposition was fierce from many sources: company executives, ministerial guardians, employee unions, suppliers and Diet members who depended on support from these various constituencies. Despite Nakasone's political skills, plus broad business and public support, he was forced to accept watered-down versions of the PCAR's recommendations and to postpone for many years final solutions, some of which ultimately were never attained.

This experience illustrates the concept of reform with Japanese characteristics. Such change includes manifest fairness to incumbents, time to adapt, reluctance to engage in confrontation and difficulty in abandoning employees and others in long-term relations. However, managing change in such a drawn-out way, and incompletely at that, leaves the privatized entities and industries at risk from a world that is changing even faster. As Japanese politicians and bureaucrats manage change at their preferred pace, they may be left even further behind than when they started, despite the unambiguous result of real, positive progress.

Table 10.1 Japanese government share sales of privatized corporations

Date	Action	Shares	Price (¥)	Proceeds (bn ¥)	Proceeds (bn \$)
1 Apr 1985	JT privatization	2,000,000			
1 Apr 1985	NTT privatization	15,600,000			
1 Dec 1985	JAL offering	2,531,000	2,270	5.8	0.03
1 Oct 1986	NTT first tranche auction	200,000	1,197,000	239.4	1.5
1 Jan 1987	NTT first tranche lottery	1,650,000	1,197,000	1975.1	12.8
9 Feb 1987	NTT first tranche cooling off release	100,000	1,600,000	160.0	1.0
1 Apr 1987	JR Central privatization	2,240,000			
1 Apr 1987	JR West privatization	2,000,000			
1 Apr 1987	JR East privatization	4,000,000			
12 Nov 1987	NTT second tranche	1,950,000	2,550,000	4972.5	36.7
15 Dec 1987	JAL final sale	48,099,600	13,414	645.2	5.2
21 Oct 1988	NTT third tranche	1,500,000	1,900,000	2,850.0	22.1
10 Oct 1993	JR East lottery	1,330,000	380,000	505.4	4.7
10 Oct 1993	JR East auction	600,000	380,000	228.0	2.1
27 Oct 1993	JR East release	570,000	600,000	342.0	3.2
15 Aug 1994	JT auction	230,000	1,438,000	330.7	3.3
27 Oct 1994	JT lottery	164,270	1,438,000	236.2	2.4
17 Jun 1996	JT offering	272,390	815,000	222.0	2.0
8 Oct 1996	JR West offer	695,000	357,000	248.1	2.2
8 Oct 1996	JR West auction	675,000	357,000	240.0	2.1
7 Aug 1997	JR Central offer	660,000	359,000	236.9	2.0
15 Dec 1998	NTT fourth tranche	700,000	359,000	251.3	2.1
13 Jul 1999	JR East release	1,000,000	855,000	855.0	6.9
9 Nov 1999	NTT fifth tranche	952,000	652,000	652.0	5.5
23 Oct 2000	NTT sixth tranche	1,200,000	1,666,000	1,586.0	15.2
6 Nov 2000	NTT sixth tranche set aside	100,000	949,000	1,138.8	10.5
21 Jul 2002	JR East final sale	500,000	949,000	94.9	0.9
8 Oct 2002	NTT purchase from MOF	91,800	532,000	266.0	2.3
15 Oct 2003	NTT purchase from MOF	85,157	431,000	39.6	0.4
12 Mar 2004	JR West final sale	634,344	539,000	45.9	0.4
11 Jun 2004	JT offering	289,334	411,000	260.7	2.4
26 Nov 2004	NTT purchase from MOF	800,145	843,000	241.3	2.2
6 Sept 2005	NTT purchase from MOF	1,123,043	458,000	366.5	3.5
29 Jul 2005	JR Central sale	600,000	483,000	542.4	4.8
5 April 2006	JR Central purchase from Railway Agency	286,071	795,000	477.0	4.3
	Total government proceeds		20,583.6	167.5	2.8

Note: Dates may be approximate as many sales occurred over a period of days or weeks. Dollars converted at average exchange rate during month of transactions.