

**THE PUBLIC SECTOR IN JAPAN—AN ASSESSMENT  
OF POLICY AND PROGRAMME**

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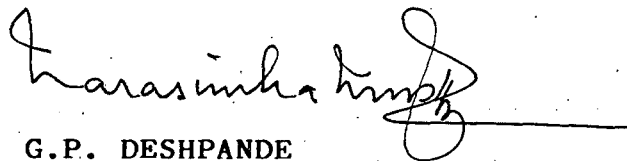


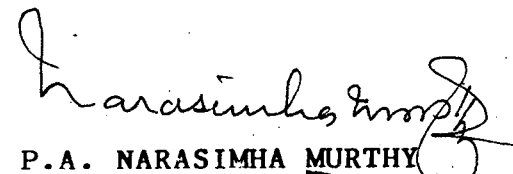
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**CERTIFICATE**

Certified that the dissertation entitled "THE PUBLIC SECTOR IN JAPAN - AN ASSESSMENT OF POLICY AND PROGRAMME" submitted by Ms. Srabani Roy Choudhury in partial fulfilment of the award of the degree of Master of Philosophy (M.Phil) in Jawaharlal Nehru University, is a product of the student's own work. It is hereby certified that this work has not been previously submitted for any other degree of diploma of this or any other University.

We recommend that this dissertation should be placed before the examiners for their consideration for the award of the above mentioned degree.

  
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## PREFACE

Japan's economic growth in the pre Second World War and the post Second World War has been mostly attributed to the state. Japan, a late industrializer followed the policy of developmental plan-oriented state which inextricably linked state to the process of economic growth. In post Second World War period too, the state considered economic growth as its fundamental goal and set to achieve this by following policies, most of which were forms of control.

The operation of the state can be through direct intervention or through indirect means. Japan during the early stage of industrialization initiated economic development through direct intervention. At other times various indirect means were used by the state to gain control over the economy such that major priorities could be achieved. The various indirect means used were laws and regulations, licensing, monetary and fiscal measures, administrative guidance and also public corporations. Public corporations form a substantial part of the public sector and are utilized by the state to channelize funds to priority areas in both strategic industries and welfare programmes, to provide public utilities and public goods and to undertake projects in

high risk areas. The overlapping nature of the social, political and economic roles of the public sector tends to hinder a comprehensive analysis of it. The task is made even more difficult because of material and time constraint. Hence, the study focuses on the public corporations, an important component both in the functioning of the public sector as well as its control mechanism. The study undertakes to see which areas of the economy the public corporations penetrates and the nature of its controls. As public corporation is a means of control, it is necessary to know how the state controls the public corporations. Finally, the study addresses itself to the recent shift of policy towards de-control through the process of privatization with two case studies of major public corporations - The Japan National Railways and The Nippon Telephone and Telegraph Corporation.

These two organisations have been chosen because they have a similar function i.e. public utility services and share a similar history. Both of these were initially a direct government enterprise. The post Second World War saw these turning into public corporations. Of late these two have been privatized. These organisations having gone through a whole range of control would provide an interesting study.

Apart from introducing the problem Chapter I defines and classifies the Japanese public sector. As mentioned above the state has played a vital role in Japan's economic growth. The state initially started off by directly controlling the economy. When this proved inefficient there was a shift to a policy of self control. Since self control took away the power of control from the hands of the government, public national companies were created to ensure some control over the economy. The post Second World War saw the emergence of a cooperative government - business relationship which allowed public corporations to flourish. By the end of the 1970s various economic changes resulted in a move towards privatization. A summary of the role of the state in various periods and the growth of public corporations is provided in Chapter II.

The public corporations have been used as a means of control. They are often supervised by more than one ministry. This allows the ministries to gain substantial control over them. Chapter III looks into how the ministries control the public corporations and guide their policies.

The policy of de-control has resulted in a move towards privatization. The reasons behind this policy and the process of it are the main focus, exemplified by the case studies in Chapter IV.

Some concluding remarks are set out in Chapter V.

I warmly appreciate the materials made available by Jawaharlal Nehru University Library, Japanese Cultural and Information Library, Ratan Tata Library Delhi University, Foreign Press Centre, Japan.

I wish to thank Professor P.A. Narasimha Murthy for patiently supervising my work. Thanks are also due to Mr. H.S. Prabhakar for helping me with relevant literature. My deepest gratitude to Suma, Sujata and Smita for going through this work and providing valuable suggestions. I am indebted to Malu, Manab, Apala, Leena, Rasmi Ranjan, Aparna and Rasmita for constantly helping me with the manual work. I am thankful to Mr. Sanjay of Type-O-Graphic Centre who carefully word processed this dissertation. Last but not least, I take this opportunity to express my humble gratitude to my parents whose support and encouragement has made this work possible.

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## CHAPTER - I

### INTRODUCTION

The state as an organisational principle evolves with the coming into existence of human society. Originally the state was required to provide defence, justice and communication. As man moved from traditional to feudal to mercantile society, the role of the state increased. It was required to provide a favourable environment for the ruling class to conduct its business. The state interfered mainly by making laws and regulations which favoured the ruling class. The internal economy was allowed to function independently and perfectly where prices and wages reached equilibrium according to demand and supply forces and this invisible hand solved the central problem of the economy viz: What to produce, how to produce, and for whom to produce.

Following the industrial revolution, the state began to take up new functions. In those societies that were the first to industrialize, the state had little to do with the new forms of economic activity, and adopted a policy of laissez faire in the internal economy. The state's main role was to provide an environment for growth of industries by protecting the



industries from foreign competition, laws and regulations pertaining to the work force. All this was possible because in those societies the capitalist class during the mercantilist stage had accumulated wealth which was invested by it in industries. But towards the end of the nineteenth century the state took on regulatory functions in the interest of reducing excess competitions, consumer protection and so forth. As Henry Jacob puts it, "Once capitalism transformed the traditional way of life factors such as the effectiveness of competition, freedom of movement and the absence of any system of social security compelled the state to assume responsibility for the protection and welfare of the individual. Because each man was responsible for himself and because that individualism became a social principle, the state remained almost the only regulatory authority."<sup>1</sup>

For the late industrializers, the motive of industrialization did not come from the roots i.e. individuals. The need for industrialization in these nations arose from 'a desire to assume full human status by taking part in an industrial civilization, participation in which alone enables a nation or an

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1. Chalmers Johnson: MITI and the Japanese Miracle - the Growth of Industrial Policy 1925-1975; Stanford University Press 1983. p.19.

individual to compel others to treat it as an individual, to compel others to treat it as an equal. Inability to take part in it makes nations militarily powerless against its neighbors, administratively incapable of controlling its own citizens and culturally incapable of speaking the international language.<sup>2</sup> Since investment was not forthcoming from individuals, industrialization was sought to be achieved by active participation of the state. This meant the state in these nations assumed greater responsibility as it took over developmental functions. Thus the idea of the developmental state had its origin in situational nationalism.<sup>3</sup> Since the late industrializers had the opportunity to study the industrialization process of the other industrialized nations, their goals were invariably derived from comparisons with external reference economies.<sup>4</sup>

These two different types of orientation - regulatory orientation and developmental orientation lead to two different kinds of government - business relationships. The regulation oriented state allows

2. Chalmers Johnson: *ibid* p. 25.

3. The sentiment and ideology of attachment to a nation and to its interest conditioned by circumstances.

4. The early industrialized nations like U.K. & U.S.A.

market rationality to dominate. This means leaving the economy to solve its problem in the most efficient manner. The state is only concerned with forms and procedures of economic competition and stresses on rules and regulations for both domestic and foreign economic policy. The centre for decision making lies in the parliamentary assembly and change in policy is marked by strenuous parliamentary contests over new legislation and by election battles. On the other hand, the developmental state is a plan rational state<sup>5</sup> where the state sets up social and economic goals and goes about achieving this effectively even if at the cost of efficiency. Since, the developmental state is goal oriented, its industrial policy plays a vital role in guiding the economy towards growth. In this system, the decision making process lies with the elite bureaucracy and change in policy is marked by internal bureaucratic disputes factional infighting and conflict among ministries.

Industrialization of Japan was not a consequence of individual effort but a conscious decision of the Meiji oligarchy. The situation in which

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5. A distinction must be made here. By plan oriented economy one doesnot mean 'command economy' of Soviet type. The plan oriented economy exists within the capitalist economy.

industrialization was attempted necessitated the state to dominate. The situational imperatives were firstly, the fact that the economy lacked a capitalist class willing to invest in modern industries. Secondly, the nation lacked natural resources. Thirdly, the nation lacked a trained and effective workforce. Fourthly, being an island nation it needed foreign trade in which the private sector had not yet developed adequate skills. In addition, Japan was faced with unequal treaties which it was forced to conclude when Perry's gunboats had arrived. These treaties did not allow Japan to exercise tariff autonomy. This meant it could not use protective duties and other practices that other industrialized nations had followed. This left the Meiji rulers with no alternative but to directly take up the process of economic development such that Japan was able to attain economic independence.

Following, the Meiji Restoration of 1868, Japan emerged as a developmental plan-rational state whose economic orientation was keyed to industrial development. Its main criteria was one of effectiveness in meeting goals of development. However, it did not have any ideological commitment to state ownership. Hence the role of state in Japan shifted between active and passive control according to the requirements of time.

The fundamental problem that a nation like Japan following state - guided high growth faces is that of the relationship between the bureaucracy and privately owned business. Japan has found a solution to the conflict that arises between the state and privately owned business by implementing three forms of state intervention. They are (i) state control, (ii) self control and (iii) cooperation. It is important to understand these forms as they feature frequently in the study.

State control attempts to separate management from ownership and to put management under state supervision. It was typically the form of relationship preferred by the bureaucrats of the late 1930s, during post war reconstruction and early stages of high speed growth. This form allows the state priorities to take precedence over private enterprise. On the other hand it promotes inefficiency in the economy and irresponsible management.

Self control requires the state to relegate its direct control to private sector. In this form, the state licenses private enterprises to achieve developmental goals. The typical institution is the state sponsored cartel in which the state authorizes

cartels in industries designated as strategic and then leaves the private enterprises to operate the cartels. In this form the nation faces greater competition and efficiency as the management is in private hands. Its greatest disadvantage is that it often leads to monopoly by big business houses.

In Japan, for a long time there was a tussle between, state control and self control. The Japanese realized that both have disadvantages which hinder development. The state also realized that even if self control is advocated the state is often required to step in and direct the economy in its growth path. This has resulted in the formation of public corporations, which allows for indirect intervention by the state. In the post war period dissatisfied by either form, the Japanese attempted to balance the advantages and disadvantages of state control and self control which resulted in the emergence of a government - business relationship of a cooperative form. The fundamental advantage of the cooperative form is that it leaves ownership and management in private hands, thus allowing high levels of competition than that achieved under state control. At the same time it allows the state much greater degree of social goal setting and influence over private decisions. This

form is based on concensus building which means virtual agreement on economic objectives, among government, ruling political party, the business leaders, the working class. This the Japanese have perfected over the years. Their cultural capability has led many<sup>4</sup> to term it as "rolling concensus", private collectivism "Japan Incorporated" and so forth.

The role of government<sup>6</sup> in Japan today is to guide the economy without hindering activities of the private sector. The government, intervenes on the economic activity of the private sector through the following measures. They are the monetary measures which include longterm loans and low interest rates for priority industries, the tax system which gives tax relief, rationalization of industries, technology development and promotion of exports, the subsidies which the government gives to enterprises, the rationing system by which government controls direct allocation. (It is mainly applied in production allocation and shipping allocation) the licensing and approval system through which government grants permission to open business and approve rates to be charged; the administrative

6. The shift from one form<sup>of control</sup> to another as Japan developed is dealt in detail in Chapter-II.

7. Richard Halloran, Hadley, Haitani and Kaplan.

guidance through which the government and the private reconcile their differences and achieve their objectives. The public corporation operates in areas that are risky, having long gestation periods, where profits are either difficult to realise or is low. This form is also used to retain indirect control on the private sector.

It is important to realise that cooperative business relationship is hard to attain and difficult to retain. Japan has achieved this as a result of historical development and because of social support system. The social support system that allows for the cooperative form of relationship between government and business are firstly, the common education which entails shared outlook between government officials and industrialist and also the practice of early retirement from government service and reemployment in public corporations and big business which allows for 'old boy' network. Secondly the workforce which is fragmented amongst labour engaged in semi - lifetime employment, small scale sub contractors and enterprise Unions. Thirdly a distribution system which serves not only to retail goods but also to keep unemployed, the elderly working there by weakening the demand for



welfare state<sup>8</sup>, Finally a system of collecting private savings through the postal system and channelizing it through government accounts to bureaucratically controlled budget (FILP) which in turn loans out to some public corporations.

### Definition of Public Sector

Public sector encompasses a variety of roles which the government undertakes either directly or through corporations and mixed enterprises to achieve its goals. The public sector as an organisation takes three main forms. It can operate as a government department, as a public corporation or as a joint stock company in which the government holds majority shares. The choice of corporate form is very popular among the government bureaucrats as it enables them to separate the costs of a particular activity from a general account budget. In addition, since public corporations are given freedom in management of their activity, they are often created to insulate an activity from parliamentary or bureaucratic politics or to channelize capital and technology into areas that are too risky or unprofitable to attract private capital. Since public

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8. In Japan subsidies have never been an important fiscal measure.

corporations are a flexible form of the public sector. It can be used by the developmental plan oriented economy to successfully attain its major goals. In this study it is on this form of the public sector that attention will be focused.

The Japanese have used public corporations since its industrialization and have perfected their role to suit their own society overtime. Public corporations come in many forms in Japan. By definition only the special legal entities (Tōkushu Hōjin) can be called a public corporation. But to distinguish special legal entities from other forms of corporate enterprises it is essential to identify other forms. Public corporations in Japan can be classified into six forms based on the proximity of an organization to its official government sponsor (a ministry or agency of the central government) and on the degree of direct control the official sponsor has over the corporation. The five categories are, as follows.<sup>9</sup>

1. Direct government enterprise
2. Special legal entities (Tōkushu Hōjin)

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9. This classification is in accordance with Chalmers Johnson typology followed in, 'Japan's Public Policy Companies (1978).

3. Auxiliary organs (Gaikaku Dantai), foundations, promotion associations and so forth.
4. National policy companies, narrowly defined.
5. National policy companies broadly defined.

#### I. Direct Government Enterprises

The government agencies that provide the public with services and products that could be supplied by either public or private corporate belong to this category. These are held in government monopoly for various reasons like there are no private takers and also as a source of revenue and government control. The history of direct government enterprises can be traced to the state - owned enterprises that existed during the initial phase of industrialization. Before the war and during the war there were eight such enterprises. They were the postal service, the forestry service, government printing (including currency and stamps), the mint, a governmental monopoly of manufacture of industrial alcohol, the national railways, the telephone and telegraph services, and a government monopoly over the production and sale of tobacco and salt. The last three government enterprises share an interesting history. They were made into Kosha (special legal entities) in 1949 and 1952 and

privatized in 1984. The focus of this study is on these enterprises. As can be seen, the direct government enterprises dominate relatively few activities in Japan. While postal service is a public utility service, printing (including currency and stamp), mint, forestry and alcohol are revenue fetching government activities. Further more none of these enterprises operates in areas that influence the general industrial sector.

## II. Special Legal Entities

Tōkushu Hōjin (literally "special juridical person") generally referred to as special legal entities perform a variety of functions that penerate all sectors of the economy ranging from production, construction, providing services and social welfare programmes. They are basically an extension of the central government bureaucracy, (though not in the legal sense) which is itself one of the most intensive public services in any open industrial society. The term Tōkushu Hōjin refers to corporations that have been created by seperate Diet - enacted Laws, which spell out the structure, governance, functions and financing of the corporation. Those Tōkushu Hōjin that

come into existence because the Ministry of Finance agrees to pay for their establishment and the Administrative Management Agency of the Prime Minister's Office is ready to designate them as special legal entities that come under the narrowly defined special legal entities. Since these two official agencies have the power of financing or recognition, special legal entities are formed not as a matter of general policy is but often with an eye on political bargaining within the central government. In short, those public corporation created by special law and designated by the government as public enterprise come under direct authorization of law. These public corporation take the form of an ordinary joint stock company, a foundation or a mutual aid association. In a broader sense Tōkushu Hōjin actually includes a much larger group of corporations. It includes local public entities also. They receive around 20% of FILP loans and are on decline as national Tōkushu Hōjin are taking over their activities.

The birth of special legal entities is mainly a feature of the post Second World War period. Their number reached its peak in 1976. These public corporations can be classified in several ways; in terms of their functions, in terms of their sectoral

concern, in terms of the ministries that control them and in terms of their degree of independence which could probably provide a more critical view of the special legal entities. But the Japanese prefer to classify them according to Japanese terminology. The official classification of the special legal entities are as follows.

1.	Kosha	Public corporations
2.	Kodan	Public units
3.	Jigyodan	Enterprise units
4.	Koko	Public finance corporation
5.	Tokushu Ginko	Special banks
6.	Kinko	Depositories
7.	Eidan	Wartime term for Kodan
8.	Tokushu Kaisha	Mixed public private enterprise
9.	Others (Kikin, Shinkokai Kenkyukai, kyosaikumiai)	Endowments, Promotion Association, Research Association and Mutual Aid Association respectively

The three kosha were formed in the post war period by the Occupation Authority by taking them away from direct government enterprises control (Type I) to stall labour unionism. The kosha were the most public of all the Tokushu Hojin. Their assets were all government owned and they were financially self supporting. Day-

today management was free from government interference. Although they maintained independent accounts they were subjected to Diet approval with regard to their budget. The three Kosha were the Japan National Railways, Nippon Telephone and Telegraph Corporation and the Japan Monopoly Corporation for production and sale of salt and tobacco. They were controlled by the Ministry of Transportation, the Ministry of Posts and Telecommunication, and the Ministry of Finance respectively. While the first two provided public utilities, the Japan Monopoly Corporation was the major revenue raising corporation. Contrary to the theory of the public corporations, these organisations were under heavy political pressure. Since the workers were paid from national treasury, they invariably had a different relationship with their employers from that of profit-making private enterprises. The work atmosphere resulted in labour unionism.

Kodan are more independent than Kosha. The kodan are only subject to the approval of their supervising ministers. They are largely engaged in construction and public work projects. Kodan are involved in large scale investment with social welfare as their main

objective, and are mainly funded by Fiscal Investment and Loan Plan.

The Jigyodan are smaller-sized kodan and undertake economic and social activities which the government encourages. Jigyodan are partly funded by FILP. Most of their funds are directly appropriated through their controlling ministries. Thus they are less independent than the more financially secured kodan.

Koko function in the realms of loans and finance. All their capital are supplied by the government, and they make loans and investments on the basis of the so-called 'policy interest rates'. They help in financing risky ventures and aid clients who do not have access to any other source of credit. Koko are thus a supplementary to the general banking system. Being an operating arm of the central government in the realms of public finance Koko are subject to both budgetary and annual plan approval by the Diet. In addition, the Koko often face interference by their supervisory ministries.

Tokushu Ginko means special bank. The two special banks are Japan Export - Import Bank and Japan Development Bank. These two banks have played a crucial role in Japan's economic growth in the post war



period. Although these banks are officially controlled by the Ministry of Finance, the Ministry of International Trade and Industry has a strong policy influence over them. These banks provide loans to private national policy companies and therefore tie these companies to the government. Tokushu Genkos operate under the same legal restrictions and apply the same policy interest rates as that of Kodan. But, the banks through repeated confrontation with bureaucracy have won greater independence in their internal management.

There are two Kinko today which have survived from the prewar period. They are the Central Cooperative Bank for Agriculture and Forestry under the Ministry of Agriculture. It gives loans to the numerous powerful agricultural cooperatives. This Kinko does not have access to FILP funds. The Bank for Commerce and Industrial Cooperatives is the other Kinko attached to the Ministry of International Trade and Industry. It gives loans to small and medium scale enterprises. Some 62.5% of its capital is held by the government, and it takes loans from FILP.

The only surviving Eidan <sup>10</sup> which were in plenty during wartime is the Teito Rapid Transit Authority. This is controlled by the Ministry of Transport and the Ministry of Construction.

Tokushu Kaisha are mixed public private enterprises and are organized as joint stock companies. These gained popularity in the 1960s as they were alleged to be more efficient than purely public corporations. Tokushu Kaisha were not subject to Diet control but still required the approval of the controlling ministers on matters like, of new stock, longterm borrowing, disposal of profits and on policy decision. Thus the government has power to interfere in these enterprises and some of them are extensions of the official bureaucracy rather than the joint stock.<sup>11</sup>

Finally, the others include a horde of public corporations whose activities are varied. They are controlled by ministries which sponsor them. These are formed in response to a diversity of problems and also serve as an opportunity for the various ministries to gain control.

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10. Eidans are the models for post Second World War kodan sponsored by SCAP.

11. A good example is Japan Ammonium Sulphate Export Company where MITI holds substantial control.

### III. Auxiliary Organs, Foundations, Promotion Associations and Others

The organisations under this category are formally private. They take the form of incorporated foundations, incorporated associations or unions. They are all nonprofitmaking enterprises or non commercial enterprises. These organisations provide the business class and the government with good office to work out their differences. These organisations have quasi official status and are often staffed by government officials and funded partly by government and partly by the Liberal Democratic Party funds.

Auxiliary organs known as Gaikaku Dantai are used by various ministries and agencies to serve purposes not necessarily economic in nature. When a ministry fails to convince the Ministry of Finance about the need for creating a Tokushu Hojin, the ministry sets up Gaikaku Dantai<sup>12</sup>. These organs also serve as a placement for retired officials. They are often created as a forerunner to Tokushu Hojin. Further, many of them are wholly staffed by active government officials and are indistinguishable in form and

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12. Information Technology Promotion Agency belong to this category was intended by MITI to be a Tokushu Hojin

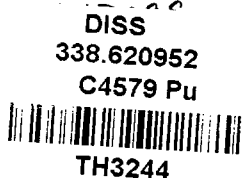
function from Tokushu Hojin and exists as Gaikoku Dantai for political reason

#### IV National Policy companies, Narrowly Defined

Narrowly defined national policy companies are often referred to as Sokusei Saibai ('raising out of season crops by artificial heat). They are located in sectors that the government wants to develop as it is too risky or unprofitable for the private sector. The Japan Electronic Computer Company is one such organisation.

It is important at this juncture to clarify that national public policy companies of prewar times were primarily 'special companies' (Tokushu Kaisha). They were joint stock companies established by special laws and their ownership was shared between private organisations and the government. These companies were established on government initiatives and financed by the government.

The post war national companies (both narrowly defined and broadly defined) have a kinship with the government which is lacking between government and private enterprises.



## V. National Policy Companies Broadly Defined

There is very little difference between the narrowly defined and broadly defined national policy companies. If one considers this category the firms classified will fall in the blurred area between enterprises launched by government initiative and those launched by purely private enterprises even though their business is regulated by the governments. The firms are distinguished on the basis of concentration of retired bureaucrats on their board of directors, strong delegation of their executives on powerful government advisory commissions and a history of direct involvement with the government, such as government assistance at birth, administrative guidance, governmental subsidies and governmental brokerage in effecting mergers or joint ventures'.

These five categories show what a large spectrum of industrial activity the government penetrates. These industries can be described as public policy companies as they range from companies having most direct government connections to those having only tenuous connection. Among them are the special legal entities which cover a wide range of economic activities. By definition, the special legal entities represent the

clearest public corporate character, though the degree of control of the government varies widely among the different types within this category. In this study it is to this category that reference is made when the term "public corporation" is used.

## CHAPTER II

### PUBLIC SECTOR IN JAPAN

#### Public Sector in Prewar Japan

Industrialization in Japan was carried out by the state as the Meiji leaders wanted to achieve in a short span what took other countries a century or more. Thus Japan followed a distinctive industrial policy, where the state controlled all aspects of the economy. In the formative years Japanese capitalism was a 'hot house variety growing under the shelter of state protection'<sup>1</sup>.

At the onset of industrialization it was realised that revival of the old industries could not provide the impetus for industrialization. The policy of the state during the formative years was to lay the foundation for large - scale industries and to modernize the traditional industries and equipping them to face world competition. The development of two types of industries presented two aspects. In the large scale industries (arsenals, shipping, metallurgy, machinery and equipment) the state followed a force draft expansion. These industries grew out of

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1. John Livingston et. al (ed): Postwar Japan 1945 to the present; New York Pantheon 1973. p. 117

government initiative through subsidy and protection. Here the aim of the state was to build enterprises essential for military preparedness and colonial development. Since the state was also the main financier, it had total control over these industries and guided their industrialization process.

In the traditional sector consisting mainly of textile industries a more diversified and pervasive modernization policy was followed. Various types of governmental incentives, bank credit, technical education were provided. The major problem in this sector was that private financiers were not willing to bear the risk of modernization. The initiative towards modernization was therefore taken up by the state. The state followed a policy of setting up model enterprises in various industries. These model enterprises incorporated industrial skills and the techniques of the West. Since private investment was not forthcoming, these model enterprises were owned and managed by the government. (Category I). The success of these enterprises ensured incorporation of the new techniques in the private sector. Slowly but surely a new entrepreneurial class grew under the aegis of the state which gained experience and achieved self confidence under state protection.



After about a decade and a half of direct state operations of the model enterprises, the Meiji leaders realised that these model enterprises were breeding corruption, bureaucratism and inefficient monopolies. At the same time a private capitalist class had emerged which was willing to invest in these model enterprises. The moment was opportune to end direct government operated model enterprises and transfer them to private hands. As a result the law on Transfer of Factories was passed. The reason stated for the transfer was, 'the factories established for encouraging industries are now well organised and business has become prosperous. So the state will abandon ownership which ought to be run by the people<sup>2</sup>".

Thus, the state gradually transferred many of the government-owned enterprises other than arsenals and large manufacturing industries. Table I (Appendix 1) gives some of the early industries that were sold to private owners. This period 1880-1920, saw a relative decline of state control and consequently the public sector took a back seat. The role of the public sector, however, remained predominant in public utilities and

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2. W.W. Lockwood: The Economic Development of Japan - Growth and Structural change; Princeton University Press; 1968. p.102.

other areas where public control was essential for political and social reasons.

This does not mean that the two types of industries that emerged were, on the one hand that which was state protected and on the other, that which followed the principle of laissez faire. The distinction according to Norman was that of, "different form of paternalism adopted by the state"<sup>3</sup>. The state retained its paternalism as before both in military and non-military enterprises but in a form appropriate to each of these sectors. While in military industry, state control was complete, in non-military enterprises the state retained control by maintaining contact with the major Zaibatsu houses. Byron Marshall has shown in detail how small a foothold the ideology of entrepreneurial independence retained in prewar Japan. 'No Japanese entrepreneur' he writes, "is recorded as having claimed the right to run his enterprise as he saw fit without outside intervention."<sup>4</sup>

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3. E.H. Norman: Japan's Emergence as a Modern State: Political and Economic Problems of the Meiji Period; Institute of Pacific Relations, Inquiry series 1977. p.128.

4. Byron K. Marshall in Chalmers Johnson: Japan's Public Policy Companies; American Enterprise Institute for Public Policy Research, Washington D.C., 1978. p. 63.

In the 1920s state intervention again became dominant for several reasons. The first was the depression which set in after the First World War and was exacerbated by the financial panic of 1927 and the world economic crisis. Second, there was rising opposition to monopoly capitalism from idealistic and nationalistic military officers and economically depressed classes. Third, to aid military expansion on the continent, a strong industrial base was required, and this could only be provided by the state.

Though both militarist and industrialist groups agreed upon state intervention, they disagreed upon the type of control. The Zaibatsu advocated self control with government role restricted to legal support from outside; it wanted cartels to end excess competition. In addition, cartels meant increase of Zaibatsu power of control. The state also advocated it because it could ensure rational use of resources and led to industrial rationalization. The outcome of this was the passing of Important Industries Control Law in August 16, 1931. The law legalised self control in the form of treaty like cartel agreements among enterprises to fix levels of production, establish prices and limit new entrants into an industry. The net result was that some twenty six important industries were cartelized.

As self control led to monopoly capitalism, it created apprehension in the minds of the people and the dollar scandal<sup>5</sup> served the final blow to the advocates of self control.

The militarist on the other hand demanded state control as it meant control of prices, quantities and production facilities which was normally achieved by elaborate regulations and plans. With self control failing, state control gained ground. The militarists' first attempt at state control was made in colonial Manchuria in respect of the South Manchurian Railway Company. As it turned out, the experiment failed and the state had to seek help from the private financiers. The militarists resorted to achieve state control through joint public - private enterprises which they termed as national policy companies (By our classification, these companies actually fall in category II, Tokushu Kaisha, special legal entities). The national policy companies were set up in line with the Ayukawa's Manchurian Heavy Industries Development

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5. On September 21, 1931, England announced that it was leaving the gold standard because of depression. Japan could not maintain gold standard if its trading competitors did not abide by it. However, Japan did not impose gold embargo and Zaibatsus bank took full advantage of it.

Corporation such that each of these national policy companies held monopoly in their respective industries. The main national policy companies were the Imperial Oil Company (1941), the Japan Power Generation and Distribution Company (1938), the Imperial Mining Development Company (1939), the Great Japan Aircraft Company (1939), the Japan Coal Company (1939), the Petroleum Cooperative Sales Company (1939), and many others set up in China. All these were joint public-private 'Special Companies' which continued to serve Zaibatsu interest but helped in rationalization and extension of government control. The second type of the public corporation was the 'control association' Toseikai which were really the old self control cartels of 1931, the only difference being that government started providing some of the top management thus gaining indirect control.

With Japan following an expansionist policy, the militarists and bureaucrats were frustrated by the fact that national policy companies were not providing them with enough controlling power. Apart from paying dividends to private capitalists, the Zaibatsu were supplying personnel other than presidents and vice presidents, maintaining a substantial power in these companies. A solution towards tightly controlled

defence state was sought by passing the National General Mobilization Law' in 1938. This law as a comprehensive mobilization statute intended to cover every aspect of war production through controlling labour, establishment of new companies, addition to capital, mergers, changes of product mix etc. Of particular interest is Article 17 of the law which used public corporations as a move towards state control. This Article authorized the formation of cartels in industries for purposes of concluding control agreements which later formed the legal basis for control associations. The control associations were the old cartels of 1931, which were upgraded, expanded and made official government organs. Takehashi Makoto writes, "A kind of compulsory cartels to fulfill production quotas, carry out assignments regarding materials and labour, and the like, the control associations were empowered as agencies of state authority to exercise compulsory control over individual enterprises... They were also empowered with authority as a sort of state organ directly belonging to either the Ministry of Commerce and Industry or the Munitions Ministry. On the other hand, however, these institutions were operated by representatives of the

major Zaibatsu, and virtually conducted on the principle of securing the interest of the Zaibatsu"<sup>6</sup>.

As a measure of gaining control the bureaucrats created public corporation which excluded the Zaibatsu financial or managerial influence. Named as 'Eidan, they were wholly government owned and government managed special legal entities. They were to provide services which were non-profit making and difficult to perform by the private sector. In reality these Eidan were used as a tool to control, 'control associations' (Toseikai) by regulating their supplies. There were seven Eidan, important among them were the Important Material Control Corporation (1942) and the Industrial Facilities Corporation (1941).

In brief, from the Meiji restoration until the Second World War, state control through public corporations and government departments was enforced to meet three goals. First, to foster industrialization; second, to aid militarism; and third, to facilitate colonial expansion. In the formative stage, industrialization was undertaken by the state with little help from the private sector. By 1880 the

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6. Takahashi Moto in Chalmers Johnson: *ibid.* p. 71.

private sector had established itself and demanded self control which became readily acceptable. With a turn towards expansionist policy the militarists and bureaucrats felt it necessary to gain state control over the economy. Though facing resistance from the private sector, by the end of the Second World War militarists and bureaucrats had their hold over the national economy. The control comprised of three layers -- the General Mobilisation Bureau of the Ministry of Munitions (looking after planning), the control association, and the Eidan. The initial postwar period was in fact a continuation of these organisations which were given greater power resulting in bureaucrats achieving state control of which they were deprived during the war time.

#### **Public Sector In the Post War Period**

The end of the Second World War in August 1945, left the Japanese economy in total chaos. In a bid to divest the economy of totalitarian controls, the Allied Powers sought to demilitarize, democratize and deconcentrate the economy. They held the Zaibatsu and the militarists responsible for the war and the first step they took was to purge military officials and deconcentrate economic power from the hands of the



Zaibatsu. The Deconcentration Policy consisted of four measures.

- (a) Restriction of designated Zaibatsu connected firms.
- (b) Dissolution of the Holding Companies.
- (c) Elimination of excessive economic power.
- (d) Introduction of Antimonopoly Act.

The above measures resulted in the dissolution of Zaibatsu cartels, reduction of their economic power and elimination of state patronage of domestic monopolies. Democratization of society was achieved by various reforms which touched all aspects of the economy. The main reforms were the land reform which led to a more equitable distribution of land among farmers, the labour reform which gave the unions, among other things collective bargaining power along with the right to strike, the education reform which did away with ultranationalist curriculum and allowed for the development of individual consciousness and personality. In the industrial sector concern with "democratization" led SCAP to enact the National General Mobilization Law Abrogation Law, which eliminated the legal basis of the control associations. This meant the system of rationing and control became

totally adhoc for the first year of the Occupation Period. Following dissolution, the control associations reconstructed themselves and reappeared as trade associations. These associations were basically control associations in all but name only.

A major goal of the Allied Powers was to stabilize Japan, and put back the devastated economy into the growth path. Launching on to economic reconstruction, the Allied Powers realised that investment from the private sector would not be forthcoming and therefore the burden of economic reconstruction was taken up by it. Lacking knowledge about the country and the people they were governing, the Allied powers relied heavily on the bureaucrats who took full advantage. Hata Ikuhito states, 'never has Japanese bureaucracy exercised greater authority than it did during the Occupation Period'<sup>7</sup>. The euphoria of democratization had resulted in adversely affecting the economy because it had disintegrated the economic control system. As a measure to gain some control, SCAP dissolved the control association (Tosiekai) and established the Economic Stabilization Board to plan, allocate and ration material and product, such that priority

7. Chalmers Johnson: MITI and the Japanese Miracle - the Growth of Industrial Policy 1925-1975; Stanford University Press 1983. p.176.

industries would benefit and also ensure production of essential materials and goods. The Economic Stabilization Board, however, did not find acceptance among ministries primarily because it cut into their jurisdiction, though the reason cited was that a similar agency<sup>8</sup> had existed during war time. The Economic Stabilization Board having hardly any power, delegated its functions to the control association known as trade associations.

As economic conditions worsened due to shortage of food, fuel, galloping inflation, and militant unionism, which resulted in frequent strikes. SCAP realised that the government required economic control in its hand to bring back the economy to the growth path. As a result, the Temporary Demand and Supply Adjustment Law<sup>9</sup> was passed on September 30, 1946 (similar to National General Mobilization Law). This made the state all powerful, providing the government with ironclad economic control powers.

Along with this the SCAP turned to strengthening the Economic stabilisation Board by ordering the -----

8. Cabinet Planning Board, the General Mobilization Board which were military - dominated.
9. Though intended as a temporary measure it lasted till the end of Occupation Period, by then MITI had made new control laws.

Japanese government to withdraw power for distribution of materials and products from the industries. The public character of the control associations (Yoseikai) was increased by making them fully state financed and state operated and renamed as Kodan (A form of Special Legal Entity). From April to December 1947, by enactment of Diet Laws as many as fifteen Kodan were established of which eight were involved in domestic distribution, four in the field of foreign trade and two in industry recovery.

The economy continued to falter under state control because of the turbulent change that was going on in society in the wake of democratization. State control adversely affected economic development as it led to corruption, lowered efficiency, inflation, irresponsible management, growth of bureaucracy and inter-ministerial fight. The weakness of state control became evident.

The first measure against direct state control came in the form of the Dodge<sup>10</sup> Line which substantially weakened some aspects of state control like rationing, price control, price support, and

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10. Named after Joseph M. Dodge, the Detriot banker who was serving as a SCAP financial advisor.

multi-tiered exchange rate. It advocated the principle of maintaining balanced and even over-balanced budget which became firmly entrenched in Japanese political culture. This had two important consequences which explain the growth of public corporations in the 1950s and 1960s. The first consequence was that of three separate national budget heads - the general accounts which remained balanced until 1965, the special account which was oriented towards named projects were segregated and audited, and the investment budget or Fiscal Investment Loan Plan which was used to finance public corporations. The second consequence was that government being determined to keep its accounts in balance followed a policy of putting new services demanded by people on 'pay their own' basis. This led to commercialization of governmental services by means of public corporations. Further public corporations with separate management and accounting found to be an excellent means for accomplishing this<sup>11</sup>.

Another factor that led the Allied Powers to venture into public corporations was the growing militant unionism which was hampering economic growth. The trend was strong in direct government enterprises

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11. Kiyohiko Yoshitake: An Introduction to Public Enterprise in Japan; Nippon Hyoron Sha. Sage publication, 1973 p.112.

because of the character and nature of such enterprises. This was particularly strong in the National Railways. As a measure of weakening the unions the government transferred the two direct government enterprise (National Railways and Salt and Tobacco Monopoly) and made them into Kosha (government monopolies in corporate form falling under category II).

Just as deficiencies of self control in the 1930's had resulted in the move towards state control, the experiment with state control which adversely affected the economy assured both bureaucrats and businessmen that a balancing of the virtues of both forms was essential. This could be achieved if a cooperation between the two could be arrived at. The public corporations (the special legal entities) while giving freedom to the management, ensured control by the government to direct economic priorities. Thus public corporations became a popular 'smokescreen' for government control.

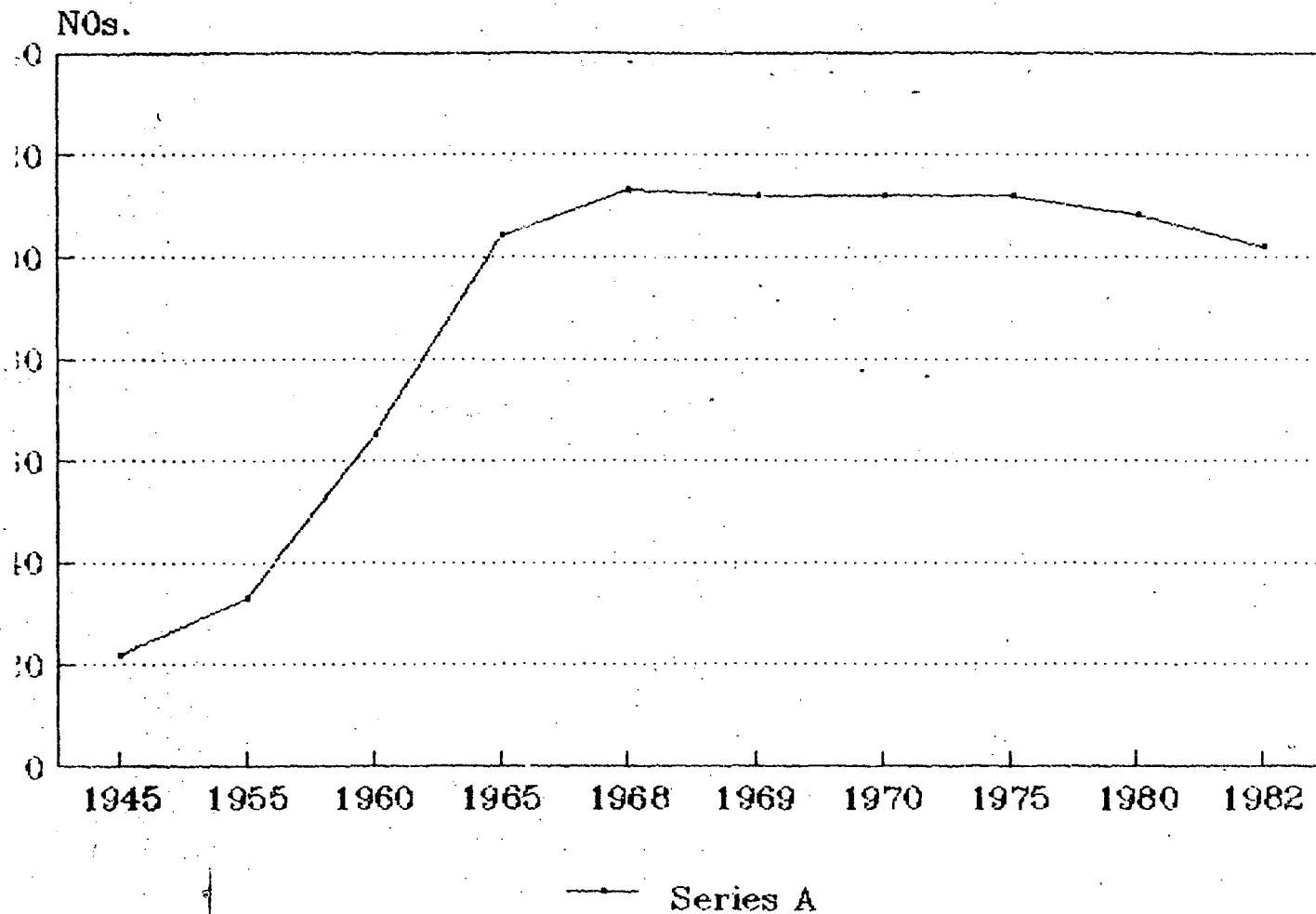
Japan regained its full sovereignty in April 1952. Sensing displeasure on the part of the private sector towards government powers of intervention, the government voluntarily gave up many of its functions by

creating mixed enterprises. These mixed enterprises were essentially special companies which gave the government substantial indirect control. Special companies were created through joint public private financing. They included the Japan Airlines, the Electric Power Development Company and the International Telephone and Telegraph Company (KDD). As a result their number grew from a mere 21 in 1945 to 33 in 1955. The Nippon Telegraph and Telephone was also made into a Kosha.

Thus for the first time, public corporations of a genuine nature came into existence. But the government continued to exercise direct control over growing industries run by the private sector, by providing guidance and channeling imports and exports as well as through technology transfer.

From 1955 through 1960 a rapid industrialization and greater diversification in industries took place. With the exception of agriculture and an extremely small percentage of industry, firms were able to make independent decisions. Though for all outward purpose Japan became a private sector economy, the government by using a battery of devices like tax benefits, legislative power to promote economic development

# GROWTH OF PUBLIC CORPORATIONS ( 1945--1982 )



Source

For 1945 to 1955, Ryutaro et. al. (ed.) (1988): P. 64

1960-1982 IIAS Tokyo Round (1982): P.55



created numerous corporation for the development of industrial infrastructure and strategic industries. These corporations were cleverly delinked from ministries thus deceiving the supporters of private sector economy. Ironically it was in this period, between 1955 to 1965, that public corporations grew by 68% (see graph).

In view of a strong and confident private sector the government came to rely upon a consensus decision making process. The public corporation (special companies) incorporating a little of both public and private sectors proved useful as it ensured indirect control. Public corporations with less business - like character dealing with social programmes, economic welfare, research and scientific matters not yet ripe for commercial developments grew in number. They are the Kikin (endowments associations) Shinkokai (promotion associations) Kenkyukai (research associations). But it is the public corporations operating in strategic industries which were of importance. These public corporations were used as an operating arm by specific ministries to serve their purpose and steer industry such that it conformed to national priorities. A good example in case of public corporation in strategic industries is the Japan Electronic Computer

Company. This is an outstanding example of a national policy company (Kokusaku Kaisha). The creation of Japan Electronic Computer Company was not the result of longterm planning of the industry but an outcome of a tussle between the government desire to control and the private sector desire to be independent. As a compromise between the Ministry of Finance, Ministry of ~~a~~ International Trade and Industry and the private sector Japan Electronic Computer Company was established as a centralized but private joint venture computer rental company capitalized by seven firms. Japan Electornic Computer Company was to provide financial backing, prevent domestic price competition by standardizing the price, provide rental services, channelize the technology through discretion. This enabled the government to control prices and influence the types of machines to be produced. Yet as a private company that needed to survive on the demands of the market it pressurized the computer makers to advance technology and reduce cost. Its dual public - private objective forced a balance and eventually resulted in Japanese computers outdoing IBM of America.

Thus two types of public corporation came into existence. Those which catered to specific industries

providing a means for control by the government and those involved in welfare-oriented areas. This policy is followed by the Japanese government even today.

An analysis of the Japanese public corporations, namely special legal entities of this period, provides an insight into how the government used the corporate form of organization to pursue diverse objectives. While public corporations for public welfare and utility are created in large numbers there are also specific national public policy companies for the sole purpose of targeting strategic industries. The 'corporate' form which involves formulation of longterm objectives and development of plans<sup>7</sup> to achieve them was best suited for these strategic industries and national public policy companies and special companies provided the required structure. As a governmental organisation it provided financial backing and as a private organisation it demanded that firms of target industries make better product and cut cost in return for government aid. Being separated from its parent ministry, its subsidies are largely invisible. It is this practice that results in a misnomer that the Japanese economy functions with a relatively small public sector.

The poliferation of public corporations in almost all areas of the economy caused dissatisfaction amongst people because of excessive governmental interference. Further since these were used as post retirement placement for top bureaucrats by the ministries many critics came to believe that many of these public corporations existed for the benefit of the ministries and was a sure way of retaining control. Growing concern over this issue led the government to form a Provisional Commission for Administrative Reform which submitted its report in 1964. This commission was a deliberative organ set up by the Prime Minister's Office in an effort to reform the entire administrative system. This commission came up with a claim that there were many public corporations which were duplicate in nature and a consolidation, reorganisation and abolition of some of the public corporations in several phases was called for. A positive action was to dismantle those lacking grounds for existence or to consolidate those performing similar functions. But the time proved inappropriate. Japan was going through a phase of fast growth which was credited to the various policies pursued by Ministry of International Trade and Industries and Ministry of finance. These ministries put forward a view that a shake up of the

system by consolidation and elimination of public corporations will adversely affect growth. In truth these ministries were actually guarding a tool by which they could effectively control the economy. This projected view was well taken and there was only a marginal decline of public corporations from 113 in 1967 to 108 in 1976.

In the period between 1960-1970 Japan achieved full employment, modernisation of industrial structure, eclipse of dual economy and a current account surplus. By most criteria it had become a developed country. But it also showed many negative aspects like creeping inflation, problems of pollution and environmental hazards. This period was fruitful in terms of indirect state control as the ministries established many public corporations to direct and guide the private sector in a fashion visualised by the ministries. Intervention of this kind came to stay.

Three principle problems faced by the Japanese economy following the oil crisis in the 1970s were first, shortterm adjustment to the disequilibrium engendered by the oil crisis. Second problems generated by growth in the previous period especially

pollution, and environment hazard. Third the change in industrial policies caused by oil price hike.

In coming to terms with the above problems there was a shift in the policies which was made explicit in 'vision for the 1970s' published by MITI. The policies followed can be divided into those directed towards specific industries requiring protection and the declining and depressed industries and into those affecting the whole range of industries. The latter policies concerned itself with environmental issues.

For both the purposes apart from enacting laws, the government, used the public policy companies for achieving desired result. In the case of depressed and declining industries, public corporations (Kodan, Jigyodan, Tokushu Kaisha) were set up to consolidate and root out excess capacity. Their duties also included finding markets and bailing out the unemployed. The public corporation in specialized fields was also created in space development, construction and management of airport.

A stagnation in the growth of public corporations occurred from 1967 to 1975 (Figure-I, see graph) and the weaknesses of the public corporations became evident. Managerial in-efficiency, labour disputes, under

employment and production inefficiency, were some of them. Further, with the slowing down of economic growth there was growing deficit. The government in 1979 decided upon a reform programme such that eighteen public corporations were to be consolidated or abolished as found suitable. It was felt that there was a decrease of importance of the business carried out by certain public corporations or that the private sector had become mature enough to take up the functions of public sector and thus eliminate intervention. The 'Scrap and Build' principle was adopted and it is hoped that by 1990 the the number of public corporation would be brought down to the 1965 level. Following a policy of consolidation and elimination many *tokushu Kaisha* were reduced. As the rationalization policy took shape in 1980 the three *Kosha* were privatized. They were the Japan National Railways, the Nippon Telephone and Telegraph Corporation and the Japan Tobacco and Salt Monopoly. The rationalization of management and enhancement of efficiency has been implemented along with consolidation of these corporations.

Analysis of the present policy followed in Japan shows two distinct trends. While public corporations

involved in utility service (Kosha) are being privatized, public corporations involved in business operations are expanding their role in various areas. In addition, public organisations such as 'authorized corporations created by invitation of private sector have been increasing. These corporations supplement government functions and play an important role in investment and finance. This has ensured government control in important sectors. Privatization on the other hand has decreased government's budget deficit.

The study of post war public sector shows that the Japanese have thought out advantages and disadvantages of state control versus self control. While state control by standard bureaucracies has been viewed as fully effective controllable in the policy sense, it often proves ineffective in competitive market operations. The private sector, though operationally efficient cannot be guided by public policy. The Public Corporations have a highly flexible middle course, responding to both policy and political directives on the one hand, and operational efficiency on the other. The tussle between state control and self control which existed from the Meiji Period has at last found its answer in a relationship of cooperation



between the government and the private sector. The public corporations have been used by the government as a means of achieving this cooperation.

Since public corporations are used as a means of control it is important to study how the state is able to control the public corporations.

## CHAPTER - III

### CONTROL OVER PUBLIC CORPORATIONS

Theoretically speaking a public corporation carrying out public activity can be fully accountable and still achieve the effectiveness, efficiency and political neutrality which is associated with the private sector. This can be achieved when the public corporations are free from ministerial control and parliamentary intrusions in its day-to-day management. The political community ensures accountability by requiring the corporation to submit itself to auditing. The board of directors are given full freedom to run the corporation, and operate as a private enterprise. The Public corporation is thus judged partly by quantitative tests of the market, profitability and financial performance unlike the direct government enterprises.

The public corporation of Japan have been criticized on these very grounds. The Japanese have adopted the approach that the presumed management advantages of public corporation need not result in any loss of political and policy direction. They have laid down a base of common control elements by law and each statute defines not only the power which the

corporation may exercise but also the methods of supervision which the government will follow. Each corporation is placed under the supervision of a relevant central government ministry which wields substantial power. Each corporation is required to prepare a business plan, a budget and a financial plan which is reviewed by the supervisory ministry. Further they are subjected to parliamentary control and auditing.

To understand the government's control over the public corporation, it is best to divide the number of controls into 3 types.

- (a) Parliamentary Control
- (b) Ministerial Control
- (c) Accountability through Audit.

(a) Parliamentary Control:

The following matters are under Parliamentary Control :-

- i) Establishment or Abolition of Public Enterprises.
- ii) Submission of Financial Reports.
- iii) Budget of Kosha and Kodan.

The first type of control exists in most other countries. This control often acts in favour of

satisfying a particular pressure group. Many special legal entities (Kodan) persist even after their original purpose is served as they were set up for the convenience of a ministry, or a pressure group etc. It is the third type of control that essentially pertains to the Japanese economy. In Japan the revenue and expenditure budget of Kosha and Kodan are laid down before the parliament for voting. This hampers commercial operations of the Kosha and Kodan as they have to publish their estimated results in advance. The rates of JNR, NTT for example, were decided by parliament as these rates affected the national economy. This decision was but naturally guided by political consideration rather than economic ones.

(b) Ministerial Control:

There are four ways by which ministerial control works :-

- (1) Appointment of the Board of Directors and their salaries (in some cases only).
- (2) Direction of general character.
- (3) Specific matters which apply to the Ministry (e.g. new establishment, abolition of certain facilities.)

(4) Financial Control:

- i) Bond Issues.
- ii) Borrowing of Kosha, Kodan, Koko.
- iii) Terms of loans for Koko (Public Corporation of loan and finance).
- iv) Rates of Eidan.
- v) Freight charges of Japan Airlines.

The above ministerial control brings to light some characteristics of the control the public corporations are subject to. First is the large multiplicity of government control. The public corporation is subjected to control not only by the specific Ministry under which it operates but also the Ministry of Finance, the Administrative Management Agency and the Board of Audit. Very often, the public corporations are under the authority of three different departments within the specific Ministry or part of it is under different Ministry. For example, the Water Resource Development Public Corporation is under the control of the Ministry of Construction, and the Minister of Agriculture and the Prime Minister's Office<sup>1</sup>. Second, financial control is almost total. Item 4 shows that the government controls

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1. Kiyohiko Yoshitake: An Introduction to Public Enterprise in Japan; Nippon Hyoron Sha. Sage publication, 1973 p.273.

the public corporation, in terms of issuing bonds, borrowing, terms of loan, disposal of surplus and management of funds. Thus tying the hands of public corporation by financial control, the freedom in day-to-day management issued by law becomes a mockery. Further each specific Ministry is required to consult the Ministry of Finance with regard to borrowing and loans. Third, though mixed enterprises like Japan Air Lines or KDD (International Telecommunication Company) have greater degree of freedom in financial area than other public enterprises as they have no limit to borrowing and have full authority over disposal of surplus, they are subjected to control with regard to issue of new stock, long term borrowings and working programme as it has to be approved by the Ministry concerned.

(c) Accountability through Audit:

Japan follows a dual system of accounts. The auditing of Auditor General is executed for almost all public corporations. In addition all public corporations are audited by the Board of Audit.

The public corporations dealing in loan and

finance face a stricter audit and accounting compared to other public corporations. Article 18 of 'Law Concerning Estimates and Settlement of Accounts' (No. 99. Law 1951) regulates that each public corporation in the field of loans and finance must make a financial statement - Inventory, Balance sheet and profit and loss accounts - and after closing the account must submit them to the Ministry of Finance.

For the local public enterprise, Article 30 of the 'Local Public Enterprise Act regulates the settlement of its accounts. According to this Article, the local public enterprise is required to submit not only the final accounts prepared according to the division of the budget but also financial statements: Profit and loss Accounts, Spare Money Calculation, Spare Money Disposition Calculation and Balance Sheet.

The system of dual accounting and dual auditing causes problems for the management of public corporation as they become answerable to two auditing committees. This results in inefficiency, duplication and wastage. Though the bureaucracy realises this, they continue with this method as it enables them to control the public corporation.

This system of control becomes clearly understandable through the following case study of The Japan the National Railway and The Nippon Telephone and Telegraph Corporation<sup>2</sup>

### **Japan National Railways (JNR)**

JNR was subjected to control on many important management matters. The Diet as well as the Ministry of Transport demanded reports on the working of JNR and made decisions on the basis of these reports. Matters subjected to Diet decision were mainly regarding the compilation of annual budget and basic rates of passenger fares and freight charges. Since these decisions were based on voting, the political factor played an important role. The Ministry of Transport dictated its authority through appointment and dismissal of the President, the Vice-President and other board members and also in the construction of new lines, suspension and abolition of any line under its operation, electrification and other major projects, borrowing of operating funds and issuing railway bonds and investment in allied enterprise. Accounts of JNR

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2. Both of these public corporations have privatized since 1984. Details in Chapter-IV.



was made according to the trading principle drawn out in Article 38 of 'The National Railway Laws'.

As a result, financial statements - Inventory, Balance Sheet, Profit and Loss Accounts were made, Additional report of the final accounts for the business year was prepared according to the division of the national budget to which it applied. Thus JNR was audited by the Auditing Committee of JNR and also by the Board of Audit.

The above shows that JNR, was under total control of the government. Though a public corporation, it had no say in the matter of rates to be fixed, its investment and planning.

#### **Nippon Telephone and Telegraph Corporation :**

Control over NTT business and financial activities were exercised by various governmental bodies. The chief supervisor of NTT was the Ministry of Post and Telecommunication. Interrelations among the government organs which concerned themselves with this public corporations is discussed below.

In each fiscal year NTT submitted its annual budget to the Ministry of Post and Telecommunications.

This was then studied by the Ministry of Finance and then submitted to the Diet through the Cabinet for approval. This was the main control of the Diet.

Once the budget was approved by the Diet, the NTT submitted its financial programme to the Ministry of Post and Telecommunication, the Ministry of Finance and the Board of Audit.

At the end of the year, the NTT was required to submit a financial statement to the Ministry of Post and Telecommunication. On approval from this Ministry, it was to be submitted to the Cabinet which in turn sent it to the Board of Audit for the review of NTT financial transactions. After auditing, the Audit report was submitted to the Diet through the Cabinet.

Rates for NTT principle services were also subjected to Diet's approval after proceduring through governmental organs, principally the Ministry of Post and Telecommunications.

NTT was also subjected to inspection by the Administrative Management Agency. This Agency essentially inspected the activities carried out and made recomondations on the inspected matters as and when necessary.

In other aspects of NTT activities like investment, operation of certain facilities such as ship-to-shore communication and communication handled by rail - roads, the Ministry of Post and Telecommunication had the final authority over sanctions.

Though NTT activities were based on supervision at the above mentioned level it was comparatively autonomous and independent as compared to JNR. This corporation did not run into deficit nor did it incur heavy cost. Here, control did not result in inefficiency in the working of the corporation.

**Indirect Control over the Public Corporation :** The system of 'Amakudari'.

So far we have seen the direct form of control that the Japanese government follows. This type of control is not peculiar to Japan alone. This exists in varying degrees in all mixed economies. The system of 'Amakudari' literally meaning 'heavenly descent' but more generally referring to the practice of retired bureaucrats finding landing spots in post retirement period, is a peculiar feature of Japan strongly connected to the system of employment followed by the government.

Each Ministry is a pyramidal structure with the head at the apex. The Japanese follow a rigid age-wise seniority system in its central governments ministries and agencies. This usually means all Vice Ministers have an equal length of service since they joined at the same time. As one of them becomes the head of the Ministry, the others are obliged to retire. Thus retirement to many bureaucrats is not voluntary in nature but conditioned by the system.

Upon retirement these bureaucrats can obtain new employment in the private sector corporates, public corporations, politics or move into business. Of these four avenues open to them, there is a legal restriction on the movement of the bureaucrats to the private sector and politics. The first legal restriction is on bureaucrats who seek post retirement employment with the private sector. Article 103 of the NPSC (Law 120 of 1947 amended by the law of 1948) makes it clear that government officials are prohibited for a period of two years after leaving public service from accepting or serving in any position with a profit - making enterprise which involves a close connection with any agency of the state, with which such a person was formerly employed for more than five years prior to separation from service. The National Personnel

Authority is entrusted with the job of scrutinizing a retired official's employment in the private sector. The second legal restriction concerns bureaucrats seeking entry into politics. An amendment of May 10, 1962 (Law 112) to the Election Law prohibits certain bureaucrats, including the Vice Ministers of finance, agriculture and construction, from entering the first 'House of Councillors' election called after their retirement.

These restrictions have resulted in diverting a certain number of officials into special legal entities or auxiliary organs for a few years. The pressure is therefore very strong to maintain these auxiliary organs and special legal entities, purely as landing spots for the retiring officials. One analyst charged that, "about 10% of all auxiliary organs are sleeping legal entities - that is, foundations and associations with no other function than to pay salaries to retired bureaucrats"<sup>3</sup>.

Since public corporations serve as landing spots for bureaucratic officials it is often cited as the reason for growth of public corporations in the post-

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3. Chalmers Johnson: Japan's Public Policy Companies; American Enterprise Institute for Public Policy Research, Washington D.C., 1978. p. 103.

war period. Since the Ministries use public corporations to provide well paid executive positions, informal norms have developed governing the assignment of available position in a single corporation. Usually a public corporation is directly under a specific Ministry and sometimes under two or three Ministries. Further when a new public corporation is set up the Budget Bureau of the Ministry of Finance is also involved. This allows for each Ministry, involved in setting up the public corporation to gain position for their Ministry. The Vice Minister or the chief secretary plan their job allocation for his classmates and juniors. What ensues is pressure politics as each Ministry tries to get a spot or two depending on the jurisdiction in which the new corporation intends to operate. An example of this is the executive posts in the Housing Loan Corporation. Of the total of eleven posts six are reserved for 'amakudari' bureaucrats : the Ministry of Construction controls the post of the President, Ministry of Finance controls the post of Vice President, the Ministry of Construction supplies two directors, and the Prime Ministers office and the Economic Planning Agency are allowed to send one director each.

The public corporations by facilitating the 'amakudari' landing spots wield and indirect control over the area in which they operate. A mix of ex-bureaucrats on the Board of Directors is useful in getting the public corporation to toe the line of the specific Ministry. For example on the board of the 'Japan Electric Computer Company' MITI places its retired officials, who have steered the computer industry through turbulent waters, and their efforts have resulted in putting Japan among the top echelon in the computer industry. The old boy net work, developed by the amakudari system has resulted in maintaining coordination and cooperative interaction among the government and the public corporation - an aspect of what the Japanese call 'nemawashi' (literally "preparing the ground work") Cyril Black writes, "One of the best indicators of elite homogeneity in ..... Japan is the frequency of 'elite interpenetration', by which the members of one segment of the administrative leadership transfer to another with little difficulty, thereby creating overlaps that further enhance the system's ability to respond to conflicts of interest"<sup>4</sup>. Thus the amakudari system promotes Japanese

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<sup>4</sup> Cyril E. Black: *The Modernization of Japan and Russia*, New York, Free Press 1975 p. 269

organizational value of frictionless decision making by maintaining a bureaucratic old boy net work throughout the society.

By the above means (both direct and indirect) the government is assured of having enough 'handles' on its public corporations to ensure the conformity of their policy. There is no doubt about the existence tension between a given corporation and a supervisory Ministry, but then because of the top management coming from the bureaucracy a consensus is arrived at without much delay, ensuring a smooth operation of public corporations.



## CHAPTER - IV

### DECLINE OF PUBLIC SECTOR : A MOVE TOWARDS PRIVATIZATION

The role performed by the public sector has turned a full circle since the 1930s. Over the past fifty years government has assumed a greater role in the economic affairs of most countries. Macro economic planning and management has come to occupy a vital place in government policy. Accompanied with this policy has been the growth of the public sector both in terms of size and expenditure. This growth has been due to an expansion in welfare programmes, military expenditure and vast increases in the range and scale of the public infrastructure and service<sup>1</sup>. This trend towards more government involvement in economic affairs has been accompanied by policies which one way or the other rationalized public sector activity. Nationalization as a policy option has naturally been very common.

By the beginning of the 1980s most nations were questioning the validity of government running or managing many of their public corporations which were

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1. Japan experienced this shift towards welfare oriented programme in 1970s.

proving to be, 'white elephants'<sup>2</sup>. Most of the public enterprises were running up huge deficits. In addition, redistribution through taxation and budgeting was becoming a less attractive policy option and probably more unfeasible for most governments, and privatization policy came as a new off-budget policy. One can actually view privatization as a result of the development that began in the 1970s which includes technological advances, deregulation and internationalization which in turn has made public corporation a less competent form of economic organization from the view point of growth and investment.

Privatization has its intellectual roots in the free market economic theory. Privatization theorists argue that the public sector has become too large and that many functions presently performed by the government can in reality be better performed by private firms, directly or indirectly, by leaving decision making to resolution of market forces. The private sector, it is argued, will perform these functions more efficiently and economically than they

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2. Britain was the first country to start the process of privatization in the world. It started selling off state owned enterprises from 1979 under the conservative government headed by Margret Thatcher.

can be performed by public sector. The reason for this lies in the theoretical premise that the most efficient and buoyant point on the growth path can be only achieved through responses to market signals. These would include price signals, demand and supply determined product and therefore, technology mixes, input and factor cost etc. Administrative prices which are a feature of public enterprises would tend to interfere with this process and hence lead to systematic inefficiencies. Morgan and England contend that 'the private sector is inherently more efficient than the public sector, primarily because it brings increased competition and reduces bureaucracy and red tapism'<sup>3</sup>. It should be noted here that public sector and private sector are viewed by these theorists as alike and as if subject to the same set of economic incentives and disincentives.

To understand privatization it is important to distinguish between two functions of government — producing and providing. Producing implies operations like delivering, selling and administrating. Providing is a function involving policy making decisions,

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3. David R. Morgan and Robert E. England, (November/December 1987). 'Two Faces of Privatization; Public Administration Review, p.979.

buying, regulating, franchising or subsidizing, Privatization essentially means handing over either of these functions to the private sector. Since production of a service is less complicated it is this function that is often handed over.

### **Modes of Privatization**

There are four policy initiatives associated with privatization and none of them is exclusive of the other. The first is called "Load shedding" through privatization. This is an old concept which states that a network of private organisations in competition with one another creates an incentive for cost containment or even reduction. Simply stated, it means transfer of a service or operation from public agency to private organisation.<sup>4</sup> The second is associated with stock or some other instruments that can be shared by non-state organizations. In some cases the government sells its share of stock i.e. goes public. The third is privatization by sale of assets i.e. liquidation of their cost value. The fourth is

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4. E.S. Saves in 'Privatizing the public sector: How to shrink the government takes the the example of picking solid waste in New York where the growing influence of its union has detopiated the service. By privatizing the unionism could be curbs.

privatization by contacting.<sup>5</sup> This concept becomes even less clear as there is 'sector blurring' - an operational notion in which traditional responsibility of the government is maintained but conducted by the private firm, and yet the government is responsible for both the policy and financial success of the private firm engaged in the activity.

#### **Objectives for Privatization :**

The promoters of privatization usually argue that nearly all public sector activities are potentially amenable to being transferred to the private sector. Therefore, the decisive criterion for allotting a certain service to either of the sectors will depend upon production or providing efficiency and/or cost efficiency. These then are fundamental objectives. Apart from these there are other related objectives which serve the purpose and strengthen the policy of privatization. The objectives of privatization are stated below : -

1. To improve actual or potential economic performance of the asset or service function.

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5. This is in a limited sense, to sub-contracting in Indian industrial context, where smaller firms produce an entire or a part of the final product for the parent company.

2. Depoliticization of the economic decision.
3. To improve, revenue through sale receipts.
4. Reduce taxes and borrowings by increasing receipts through sales of government enterprises.
5. Reduction in the power of public union.
6. To promote wider ownership of assets by eliminating national monopoly.
7. Reducing Budget Deficit. Virtually every government today is running a deficit and finds it increasingly difficult to meet growing demands of promoting existing and newer public goods. By bringing the private sector into producing public goods the government is able to concentrate its appropriations in other areas where risks are high and private sector cannot be expected to provide an adequate supply of goods and services. Privatization therefore has the potential of a more effective allocation of limited government funds.

#### **Privatization Hurdles :**

building up of public opinion which encourages this policy. This is essential because people may be threatened by the prospect of private sector entering

public sector realms as public interest will be relegated to the background leaving centre stage to profit maximization. Government can step in here by making laws that bind the private firms entering this field towards public interest, the limit to which will be set up by the extent of decontrol envisaged. Bureaucratic administrations and employees of public enterprises are a strong section of the society who loathe privatization as it takes away security and power. To the bureaucrats and the employees working in a public corporation it guarantees them employment, provides social security and benefits, and ensures post retirement security. To the bureaucrats, the public corporation, whether involved in producing or providing services is a means through which to control the economy even if only in a limited sense. Thus privatization to the bureaucrats often means loss of power. This section of the society can be brought around by measures such as ownership of shares, incorporation of them into new firms, making other arrangement for the unemployed due to privatization.

A small, efficient government sector with certain degree of control over private sector such that vital

interests are not overlooked has become the aim of most nation-states.

This backdrop on privatization has been provided for a better understanding of Japan's policy of privatization. To understand Japan's privatization policy it is essential to look into the problems that arose which forced the government to look towards privatization. While dealing with privatization in Japan, two cases of major privatized companies, Nippon Telegraph and Telephone and Japan National Railways, will be considered.

#### **Privatization in Japan :**

The Japanese economy has been recovering from a slump which it faced in the early 1980s. Many writers have attributed the slump to 'endaka' - the sharp appreciation of the Yen. Japan has experienced Yen appreciation three times since 1945. The first time (1971-1973) Yen <sup>appreciated</sup> from ¥ 360 to about ¥ 270 to the dollar. The second time (1976-1978) it appreciated from ¥ 295 to about ¥ 200. In 1985 the Yen soared from ¥ 240 to ¥ 140 (1987). The appreciation of the Yen was bound to have a deflationary effect. But it is interesting to note that Yen appreciation in the past



(1971; 1976-78) had not led to declining growth rates. While the growth rate faltered temporarily in 1971, the economy grew 9% from the following year. In the second period i.e. 1976-78 the growth remained at a low, but steady 5%. This time, however, growth showed a steady decline from 5.1% in 1984 to 4.3% in 1985 and 2.6% in fiscal 1986<sup>6</sup>. The government in previous periods had pursued a policy of decreasing external surplus and balancing the budget without correcting the saving investment imbalance, thus only affecting growth rate marginally. The third period also saw a growing deficit in central government budget and increasing debt servicing cost. To help the economy bounce back to life it became essential to overhaul the entire system. The then Prime Minister Nakasone Yasuhiro set up the Second Special Administrative Research Council to look into the major domestic issues and consider ways and means of reforming government finances and administration particularly the bloated size of the central government and the tendency towards financial expansion. Further there was growing concern to maintain economic growth rate at 5%. The Economic Planning Agency was also concerned about how the new

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6. Ichio Takenaka : New growth through privatization  
Japan Echo. no.4, (1987), p. 47.

era would affect the lives of Japanese people and conducted a long-term study on the projected life style of the Japanese people in the 21st Century. The final report proposed that if circumstances remained as they were the fiscal deficit would swell to a colossal scale resulting in fiscal breakdown. Among the many policy reforms suggested for the domestic economy, privatization of three major public corporations and other special corporations was one. It became evident that if privatization was done through sale of stocks in public corporations it could be used to pay off national debt, and realise a reduction in debt service cost. The impact on the financial market would be neutral, for the funds received from private sector for the stocks of denationalized enterprises would be returned to the private sector to pay-off government bonds. A study published in July 1987 by the Research Institute on National Economy<sup>7</sup> estimated that the total value of stocks of 34 major government-controlled organizations (8 special entities, 13 public enterprise, 12 financial institutions and postal saving system) to be between ¥ 171 trillion to ¥ 294 trillion. And in either case the estimate exceeded

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7. Ichio Takenaka : Japan Echo no.4, (1987). Ibid., p.50.

national debt. The social situation also favoured privatization. On April 26, 1982 'Yomiuri Shinbun' published results of an opinion poll of 3,000 people conducted a few weeks earlier. Of many results derived from this opinion poll, it is noteworthy that respondents who favoured split up of JNR into a number of regional networks run by smaller public or special corporations amounted to 22% while those who wanted to split it up and put it under private management amounted to 42%. Further, public corporations were seen as a burden on the people as they ran up deficits, failed to innovate, faced labour union problems and suffered from managerial complacency.

In short the public sector in Japan was widely perceived to be beset by several problems :

- i) A bloated public sector (both in administrative organs as well as the public corporations) had affected efficiency in terms of producing and providing services and also its cost.
- ii) A mismatch between the goods and public utility services provided by existing public enterprises and those required by the people due to changing socioeconomic conditions. For example, greater

overseas trunk dial service required by people not being matched by NTT.

iii) In several areas private corporations had come to coexist with public sector enterprises and were seen to be more efficient. Privatization was seen as a remedy for existing inefficiency and high-cost.

On the international front Japan was facing a different problem. Its balance of payments surplus was staggeringly high and it was pressurized to open its economy essentially by the deficit countries like USA. The Maekawa Report which looked into this problem came up with many policy recommendations among which privatization was one. It was felt that if Japan privatized public corporations which were seen as a monopoly, foreign firms would enter Japan's domestic economy and participate in providing services. This would lead to a decrease in Japan's external surplus.

Japan, initiated privatization by selling off Nippon Telegraph and Telephone Corporation in 1984 followed by privatization of State Tobacco and Salt Monopolies. Japan National Railways was privatized in 1987. The case studies of NTT and JNR would highlight some of the motives behind privatization.

## Japan National Railways (JNR)

The first railway service in Japan started in 1872. For the next 40 years this single service multiplied into 17 privately owned lines. In 1906, the government bought the 17 lines, integrated them into a national network, and took control. Nationalization resulted in the railways functioning as a government department. Formal responsibility for the execution of the budget lay with the Ministry of Railways and later with the Ministry of Transport.

A remarkable move in the postwar history of public enterprise is the introduction of Public Corporation System in June 1949. Railways were separated out and made a public corporation and renamed as Japan National Railways. This move was initiated by the Occupation officials to serve two purposes. First, as a measure of democratization of the Japanese economy. Second, as a solution to the urgent labour dispute of the Civil Servants Trade Union in 1948. The Railway employees belonged to the Civil Servant Trade Union which had become militant and disrupted work by calling strikes. By separating railways from other government departments, the employees were separated from the

Civil Servant Trade Unions and their bargaining power was curtailed.

Since JNR, was the first public corporation (Kosha) for the first three years there were no clear legal laws pertaining to this organisation. There was no clear form of board system to control JNR<sup>8</sup>. The President of the JNR had monocratic power over the entire organisation. By 1952, it was realised that to run a public corporation powers should be well defined and distributed. A board system was constituted along more democratic lines in 1952. A Board of Directors comprising of an ex-officio (namely President of JNR) and five ordinary members was introduced. These five members were nominated by the Cabinet and ratified by the the Diet. These members were required to have wide knowledge and experience in the field of transport, industry and commerce. These qualifications demonstrate that the Board was required to be a working form of a 'policy board'. In contrast to the ambiguous formulation and competence of the previous board, the new Board of Directors system was clearly declared to be the highest policy making organ.

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8. An advisory committee existed without a clear formulation of legal competence.

In 1956 some further changes were made which lasted till privatization of the organisation took place. The Japanese terminology of the board was changed from 'Keiei iinkai' (literally meaning Managerial Committee) to 'Riji Kai' (literally meaning Board of Directors). A major change was made in nomination of the Members of the Board. While earlier the Cabinet nominated the Board members, the power of nomination was passed on to the President of JNR. There was restructuring of the Board. On the top were the Board of Directors. The number increased from 10 to 17 by 1980. The President was nominated by the Cabinet. While the other members were nominated by the President of the JNR with the approval of the Ministry of Transport. Thus, the Ministry of Transport gained substantial control over JNR and were responsible for business activity in specialized field. An Audit Committee was also set up for the first time with members appointed by the Ministry of Transport. This committee was responsible to the Ministry of Transport and the Board of Directors.

As retired bureaucrats moved into management of this organisation, the JNR soon became a replica of the government structure. Instead of there being a single department in one aspect of the organisation, there

were subdivisions which operated separately. For example, instead of a single department specializing in railway engineering, there were separate departments to handle technology pertaining to tracks, electric power and train operations. Further control departments were broken up into small units like business management, labour management, materials and accounting. Each of these departments acted as an independent government organ and regarded itself as the most important. This often resulted in interdepartmental friction especially concerning budget allotment and affected efficiency.

The JNR is an excellent lesson of how a profit making public corporation can end up accumulating a large deficit because of inefficient handling of the organisation. JNR had for the first 15 years provided service incomparable in terms of efficiency and development of rail road network. It had earned enough to offset the growth of expenditure due to expansion of each department. This was possible because there was increase of both freight and passenger transportation.

Two conditions that favoured the growth of JNR were regional monopoly in transport and high economic growth that the country faced. JNR held regional



monopoly, during this period because of the problem of penetration of other modes of transport or lack of infrastructural facility. Economic growth allowed for larger transportation of new materials and goods and also demanded superior service. Thus the freight carrier service did a booming business during this period. Further, with fewer government jobs in the offing, the JNR employees considered themselves fortunate enough to be working in a government department. They were more disciplined and efficient. The unions were not belligerent and relied on arriving at a concensus with the management. JNR during this period became an impressive public service organisation.

Unfortunately the two essential conditions did not last for ever. Regional monopoly held by JNR was the first to go. Around 1964, with the growth of automobiles and construction of highways many people shifted to privately owned automobiles. The freight operations also moved in favour of road transportation. At the same time long distance travellers switched to air transport as new routes opened. Thus from a monopoly situation, JNR became a substitute and that too a poor third. It started losing ground and began

incurring deficit. By 1966 JNR had accumulated deficit of ₹ 5.36 billion. The oil crisis of 1973-74, was seen by many as a revival of the railways as other modes of transport would become more costly. Contradictorily oil price hike did not stem the tide of people's choice. As a result of slow down of economic growth, freight operations also saw a decline. As government handled JNR finances it demanded JNR to cut down expenditure.

Faced with challenges from other forms of transport it was essential for JNR to narrow down its operations in areas in which it held a comparative edge over the others. This would have enabled JNR to earn profits and curtail its growing deficit. This also meant that an internal upheaval was necessary. Consolidation of managerial set up, cutting down of investment, reduction of business and cutback of labour was essential. But with an organisation obsessed by growth, lacking leadership and internal control JNR found itself incapable of pursuing any new policy towards reduction of its operations to a well balanced scale.

Contradictorily, JNR continued to employ new workers under the pressure of various unions. Only in 1979, it adopted a policy of not hiring new employees

and by implementing various measures succeeded in reducing the bloated pay roll by an impressive ₹ 127000. Even then at the beginning of 1984 JNR employed 305000 people of whom 61000 were regarded as surplus. The efficiency and discipline for which JNR employees were once credited also declined overtime as unions gained strength in the organisation. Since the JNR employees worked as government employees they invariably had different relationship with their employers. Being paid from the national treasury, their salaries were not linked to profit. Railways being divided between public and private sector (a few lines one operated privately) often created conflict between the workers and the official as the workers compared themselves with the worker of the private lines.

A survey by the JNR made of its own organisation in April 1982 revealed that a large number of workers indulged in unauthorised leave and drinking during work. This was possible because unions intervened in their favour in cases of both promotion and retrenchment. The survey also brought to light the shift of power from the hands of the superior authorities to the hands of the workers which was a result of union strength. With guaranteed job and pay the workers had no interest to increase productivity. On the other hand public

protest through workers of various unions kept the fares low. With neither an increase of productivity nor of fares the deficit continued to grow.

Another important factor that allowed JNR to reach a level of bankruptcy was that its operational funds were guaranteed by the government. This allowed for lackadaisical attitude on the part of management and misdirected allocation of funds. Whenever deficits were registered, managers looked towards the treasury for subsidies and loans which were made available under political pressure.

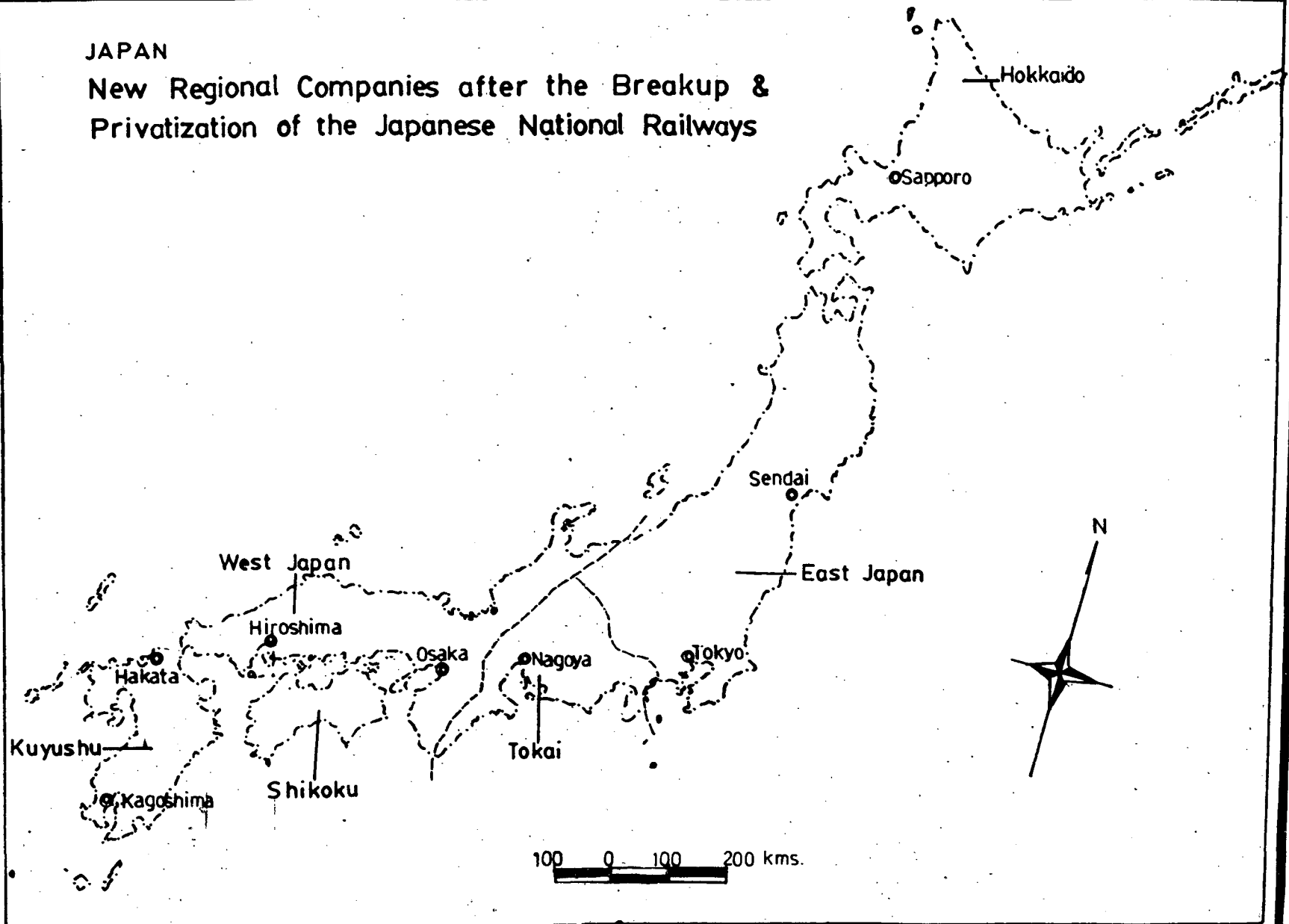
All this resulted in JNR becoming a burden on the government by 1984. When it went private, it had accumulated ¥ 12.28 trillion deficit. Its annual deficit was ¥ 1.65 trillion and longterm debt ¥ 21.83 trillion. The accumulated deficit and longterm debt combined exceeded JNR revenue during fiscal 1984 by ¥ 3.36 trillion i.e. over 10 times.

#### **Reforms in JNR and its changes**

JNR went private in 1987 on the recommendation of JNR Reform Commission. This was based on reports of JNR Reform Commission. The Japanese National Railway

JAPAN

New Regional Companies after the Breakup & Privatization of the Japanese National Railways



Reform Bill urged JNR to undertake some drastic changes such that it could be pulled out of the sorry state.

Following were the basic policy changes prescribed :

- (a) Separation of the JNR's passenger and freight divisions.
- (b) The break up of the passenger division into six regional companies.
- (c) In consideration of the special characteristics of freight transport, the establishment of a single company to handle nationwide freight traffic.
- (d) The four Shinkansen lines to be handled by a special body and lines leased to three new regional firms.
- (e) The JNR passenger division divided into three private firms covering the Islands of Hokkaido, Shikoku, and Kyushu and three firms covering eastern Honshu, western Honshu and the Tokai region. (See map).

The above changes brought about structural reorganization in the JNR which is expected to undergo further transformation over the next few years.

### **Relaxed Regulation :**

The bill seeks to relax government control of the new enterprises and approval of the Minister of Transport would not be required for matters like issue of stock, appointment and dismissal of directors and other important matters. The new firms would be free to diversify into a wide range of activities such as distribution and real estate. This would ensure vertical integration of transportation. Privatization would also give full scope to the new firms to attract consumers.

### **Employment of Workers :**

Unlike the NTT, JNR had surplus workers to the tune of 93,000. Government proposal claimed that 32,000 would be distributed among the new companies for their new business activities, and the remaining 61,000 workers would find jobs outside. Of the 61,000, 33% were to be retired, and the rest were to be taken on by the liquidation company which within three years was to find jobs in central government and related corporations, local government and private sector.

### **Financial Changes :**

As mentioned earlier, JNR's long term debts and deficit combined to exceed JNR revenue. The government planned to repay these debts from earnings made by selling it to the private firms. Whether the government will be able to pay back the debt depends upon the estimated value which is yet unknown.

Privatization of JNR was long overdue. Success of the break up, and takeover by the new firms, remains to be seen in the future. For the moment one should appreciate the determination of the Japanese government in following this policy in view of resistance shown by the corporation's unions. The possibility of privatization was made real, due to the public opinion that the Japanese government had created in its favour.

### **Nippon Telephone and Telegraph Corporation**

Telecommunication technology came to Japan from the USA. From its inception, public telecommunication has been handled by the government. It developed satisfactorily as a government enterprise until Second World War. This industry was nationally managed and its expansion was determined by the government's financial position. It was regulated on the same lines



as a general administrative organ. During the war, telecommunication faced a tremendous set back as its network was severely damaged. After the war, the government continued to handle telecommunication which proved to be inefficient due to lack of promotion of technology and other institutional restrictions. In order to achieve swift and effective recovery, the telecommunication department became a public corporation, and thus a monopolistic system was created in 1952.<sup>9</sup> Nippon Telephone and Telegraph was given monopoly in domestic service and Kokusai Denshin Denwa Company Ltd. (KDD) was given monopoly in international service. KDD was made a joint stock company, capitalized by the government and had greater freedom than NTT. As a public corporation NTT's assets were all owned by the government. The President was appointed by the government for a fixed tenure and had freedom in day-to-day management. But government control over financial matters was total. Structurally, on top was the Board of Directors consisting of seven members which included the President and the Vice-President. The President and Vice-President were appointed by the Cabinet with

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9. This was done in line with Tennessee Valley Authority of USA which had proved very successful.

consent of the other members. The other five directors were selected not on the basis of representation from within the field, but for their managerial ability. (Law of NTT Article 12). Under them were the General Managers and other managers who assisted or acted for the President and Vice-President. NTT also recruited two Auditors to audit business operations managed by the President and other officers. They were completely independent from the executive body.

NTT set itself two major goals when it began to operate independently as a public corporation. The first was 'elimination of backlog in subscribers applications' and the second, 'provision of long distance direct, dialing facility'. 'Immediate installation, immediate connection' was the motto. This was attained by late 1970. By 1984 the number of telephones in Japan was over 60 million, or 50 per 100 persons. Thus by the 1980s Japan had become a sophisticated telephone society which provided free flow of information and also ensured privacy of communication. Having telecommunication under a monopoly also ensured orderly development of telecommunication throughout the country. As a government monopoly operating under the umbrella of an extremely generous rate structure in the world's

expensive economy, NTT soon became the biggest telephone company in the world with revenues of about \$ 19.3 million (1984).

Electronics and telecommunication have revolutionized the flow of information. Computer technology has added a new dimension to telecommunication. The technology today is such that many components in telecommunication can be individually produced. Progress in technology of interface between networks has made coexistence of network possible. This has encouraged private enterprise to move into telecommunication business.

Public needs for telecommunication has increased and diversified. Specific services are demanded for various needs. Telecommunication in 'information society' has come to play a vital role demanding an extension of NTT service. The growth in telecommunication, it was felt, lies in highly sophisticated range of end use machines which NTT cannot provide by itself.

For the NTT, its growth as a monopoly had reached its peak when it was privatized. Though it was generating almost 70% of its capital needs internally

its telephone business was approaching a saturation. Money making units like telegram and telex were on the decline as customers were shifting to facsimiles, data circuit and other advanced formats of communication.

On the other hand forced by the Japanese custom of lifetime employment and pressure of the unions it was being forced to carry more employees than its productivity gains would warrant. Its profit margin having halved over the years, it was predicted that NTT would soon be in red. A comparison of NTT with JNR shows that its position in 1984 was almost a replica of JNR in 1970s.

The privatization of NTT was thus a proof of considerable foresight on the part of the policy makers to overcome any other JNR.

An advisory committee was set up to consider reforms of NTT. This committee adopted the following principles.

- (a) To abolish monopoly in telecommunications in order to introduce competition.
- (b) To reorganise NTT into a private entity.

## Reform of NTT

Based on the above principles, NTT was privatized on April 1, 1985. Through this it was thought that NTT will undergo major transformation. 'Privatization' said Hasashi Shinto<sup>10</sup>, 'is not an end in itself but a way of accelerating Japan's emergence as an information society'.<sup>11</sup> Capitalized at ¥ 780 billion and with over 320,000 employees the new NTT is Japan's largest private enterprise. At present government insists on holding 50% of NTT stocks and bans foreigners from buying NTT stocks.

With privatization NTT faces competition from such newcomers as Diani Denden Inc., Japan Telecommunication Company and Teleway Japan. Though NTT is in a much stronger position because of its long experience, to ensure fair competition, the Ministry of Posts and Telecommunications introduced changes that are advantageous to the new firms which plan to link their trunk cables with NTT city cables. This will destroy NTT monopoly on local city cables where high access charges were made.

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10. Hisashi Shinto was brought out of retirement to rationalize NTT.

11. Richard Phalon, May 1, 1985. 'NTT sheds monopoly' in Telephone Engineer & Management, p. 143.

### **Structural Reorganization :**

To overcome problems created by the erosion of its monopoly, NTT is involved in restructuring itself. The public NTT was divided into 11 regional telecommunications divisions. They have been turned into regional headquarters while the head office has been reorganized into 8 departments. This is to install a business like approach.

### **Employment**

The best part about privatization of NTT is that though there was initial scepticism on the part of the union, once it was made clear that most of the workers would be re-employed (320,000) or be incorporated into the company's subsidiaries, they did not prove a hurdle.

### **Financial Changes :**

Having been privatized the NTT will have to grapple with dividend payout policy, bond ratings and the great equalizer-the income tax. As a government organization NTT had to give a part of its earnings to Japan's deficit budget. As a private company it will be liable to 50% corporate tax.

Privatization of NTT is a well thought out policy. Though a profit-making organization, it was bulging in size and handling too many areas where private firms have capability. Its very size was bound to make it lackadaisical with no competitors. A thoughtful step by the administrative reformists has made competition possible. How far NTT will continue as a profit making organization after fulfilling its obligation, in the face of severe competition, remains to be seen.

To conclude, both of these public corporations were crucial for industrial development as they linked up the entire economy. The inception of these organisations was made under government monopoly not only for the above factors but also because of economic reasons. These organisations deal in areas that have high initial risk, long gestation periods and large scale investment. Therefore, the private sector was not ready to provide this service. Today, both these organisations have been privatized, though at different levels of their growth path. While JNR was privatized when it had accumulated a high deficit, a situation which calls for privatization, the NTT was privatized at a time when it was earning surplus. But then its profit margin had been narrowing over time because of saturation of its business. Timely privatization was

seen as a way to avoid another JNR. Privatization was possible because while the government was willing to follow a policy of decontrol and sell these organisations, there were many private houses which were willing to step in to provide these services. This is because these industries. These industries having expanded, matured and stabilized under the aegis of government agencies have now become profitable ventures. In addition, technological changes have made investment in these industries profitable for private venture.

The point that emerges from the case studies is that, though these organisation have been privatized, the government has withheld as much as 50% of their stocks in its hand, further, it has banned entry of foreign investors from buying shares in these industries. Thus, the government has not effectively decontrolled these organisations. All it has done is to hand over these public corporations to the domestic private sector such that they become domestically competitive. As far as internationalization policy is concerned, privatization of these organisation has been futile.



## CHAPTER V

### CONCLUSION

The major goal of the Japanese state has been economic growth and public corporations have been used as one of the means of control to achieve this. Public corporations as a form of public sector organisation has been necessarily the best instrument to gain indirect control over the economy. It is also used to execute certain public purposes where operational efficiency is a major concern and in areas where the private sector for various reasons is not expected to develop. It also serves to channelize funds into areas which are considered to be vital.

In the pre Second World War era, public corporations were used by the militarists to gain control over the economy and to use them to further their expansionist policy. In the post Second World War period there has been successive growth and evolution of public corporations. Though public corporations continue to operate as an instrument of control they have proliferated in areas with less 'business like' character. Only from the 1970s, the Japanese government's policy of constraint and 'no

growth' of public sector has resulted in consolidation and reorganisation of the public corporation and has reduced their number. This trend along with other factors has resulted in the 'sell-off' of the Nippon Telephone and Telegraph Corporation and privatization of Japan National Railway.

From this study, two broad conclusions can be drawn. First, public corporations have been used as a means of control to guide the economy in its growth path. This in the post Second World War period has often resulted in public corporations moving into strategic areas to provide shelter against international competition and to channelize technology. Second, overtime, especially since the 1970s there has been a blurring of the public and the private sector as the organisations meant for attaining public purposes are deliberately adopting public and private characteristics. Most often the relationship between public and private sector is viewed as a zero-sum game where the increasing prosperity of one sector is achieved at the expense of the other. The public sector and the private sector have come to depend upon each other and have inextricably linked themselves. This development of consensus and cooperation between the two sectors leads one to predict that in future the

size of the public sector will shrink providing services where private sector fails but it will increase its power and control by establishing laws and regulations such that it has enough 'handles' on the private sector to guide it towards economic growth.

In theory a full measure of accountability can be imposed on a public authority without requiring it to be subjected to ministerial control in respect of its managerial and economic activity. Chapter III shows that in Japan, however, public corporations are subjected to control by the supervising ministries in varying degrees. Apart from legal control the system of 'amakudari' (literally meaning descent from heaven) which ensures retired bureaucrats post retirement employment in public corporations acts as an indirect control as the bureaucrats pledge their loyalty to their ministry.

Privatization was recommended for various reasons like government budget deficit, inefficiency in public corporations, labour union problems, reducing surplus balance of payment and also as a means of internationalization. Privatization may have succeeded in creating efficiency, decreasing deficit and reducing labour union problem but on the question of decreasing

surplus balance of payment and internationalization it has failed as the government has banned the foreign investors from buying the shares of the privatized organisations. Then by de-control the government has only allowed private domestic investors to move in and made these industries domestically competitive.

By looking into the process of privatization in Japan one major observation that can be made is that unlike many countries (United Kingdom for instance) Japan has had a smooth move towards privatization. This was possible because of consensus building between the government, management and the workers and creation of public opinion in its favour. The responsibility taken up by the government to find reemployment for a majority of the workers was yet another factor that contributed towards the smooth process.

The case studies of JNR and NTT show that privatization works best when it is seen as a positive process and not as a means of repairing damages. Though JNR was privatized to repair damages and make it product efficient as well as cost efficient privatization also sought to spread wealth among shareholders and welfare among people. In case of NTT privatization was a foresight on the part of policy

makers. Bulging in size with decreasing profits it could have soon become another JNR. The organization was working in an area where technology innovations and expanding demand of the public had made monopoly obsolete. Though these factors pointed towards privatization, the state could have continued to hold it, as its revenue was contributing significantly towards the budget and curbing deficit. By privatizing it, the state has shown a positive outlook towards privatization.

A comparison between privatization of these two organizations and the 'sell off' of the direct government enterprises in the 1880s is interesting but beyond the scope of this work. The direct government enterprises were operated by the state because private investment was not forthcoming as the area was considered risky. Once the capitalist class grew and the market had established, the capitalists themselves demanded full control over these industries. Similarly, the two organisations at the time of privatization had expanded their function, established themselves and created a stable market. The private investors were willing to invest in this area as the long gestation period and the risk period has been

taken care of by the government through nationalisation. Thus while government was willing to sell, there were private investors willing to invest.

As mentioned elsewhere, the public sector in Japan will shrink in size by allowing private sector to move into areas where it can be operationally efficient but the public sector will increase its power and control by establishing laws and regulations. Direct control will slowly disappear except where private sector is unable to function. The public sector will continue to remain dominant only in areas of national importance.

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## APPENDIX I

TABLE I : The table gives an indication of the low price of sale. The price of transfer is compared only to the expenditures of the Department of Industry on the enterprise concerned.

Name of Company	Price of Transfer	Government Expenditure
Furukawa Cement Company	250,000 Yen	468,000 Yen
Innai Mine	75,000 Yen	195,000 Yen
Kosaka Mine	200,000 Yen	547,000 Yen
Shinagawa Glass Factory	80,000 Yen	189,000 Yen

Source : E.H. Norman pg 131 (Footnotes)  
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