10 Years of JR Operation—The Explicit and Implicit Aims of JNR Privatization

Ian Smith

Introduction

The Japanese National Railways (JNR) was privatized on 1 April 1987. The 10th anniversary of that event has recently been celebrated, providing observers both in Japan and other countries with a suitable opportunity to assess the results of the privatization. My earlier study(1) addressed this issue, but only 5 years had elapsed since the privatization into the group of seven JR companies (JRs). The main conclusions of this earlier work were:

- That the implementation—in the face of entrenched opposition—of the privatization was a major political achievement by the Nakasone administration and represented the most tangible result of the government's Administrative Reform programme.
- That the JRs were able to maintain services while remaining in profit, in contrast to the huge losses made in JNR's latter years.
- That the JRs had reversed the fall in market share apparently endemic under JNR management.
- That the JRs had been able to avoid fare increases, again in stark contrast to the final 10 years of JNR.
- That the lower incidence of labour disputes indicated that labour-management relations had improved compared with the JNR time.

However, measured against these positive outcomes I also concluded:

- That drawing up of consolidated financial accounts for all seven JRs, the JNR Settlement Corporation (JNRSC), and the then Shinkansen Holding Corporation (SHC), showed that they remained substantially loss-making as a whole, and that the level of annual interest costs had actually risen significantly from that borne by JNR in its last 5 years.
- That capital investment in the initial years of the JRs had fallen substantially below the level in the latter part of the JNR era.
- That the level of debt carried by JNR's heirs, including JNRSC and SHC, had actually risen since 1987, in stark contrast to the intentions of the privatization proponents.

Sufficient Time Span

In reaching these conclusions at the end of the initial period of privatized operation of the former JNR network, it was acknowledged that 5 years was not a sufficiently long period in which to make definitive judgments on the privatization. While an objective decision on the appropriate length of time on which to base such an exercise is difficult, in this article, I suggest that 10 years of privatized operation does provide a long-enough period for the strategic decisions made by the new company managements to have borne fruit. It is acknowledged that the capital investment cycle in the transport sector is longer than a decade, but enough time has now elapsed to make a reasonable judgment on the operating strategy of the JRs.

The Basis for Analysis

The appropriate starting point for a new analysis might be deemed to be an examination of the results of the privatization measured against the objectives set out by the policy's proponents. Such an approach could be validated on the basis that it is reasonable to evaluate the consequences of a particular policy initiative in relation to the aims of those who sought to carry it out. However, this approach leaves me vulnerable to the accusation that the analysis has involved acceptance of the premise that the objectives of the original proponents of privatization were a sufficient basis for judgment of the policy's success or failure. On this matter, it is my view that the privatization was as much a political as it was an economic policy and that its aims were a reflection of the beliefs of a particular political ideology. As such, it is not acceptable to judge the success or failure issue simply by evaluating it against the objectives of the interested parties who wished to see it implemented.

Transport Minister Ryutaro Hashimoto (Prime Minister today) in the Nakasone Cabinet signalling the birth of the JRs at 00:00 on 1 April 1987 from a steam locomotive. As Finance Minister in the Kaifu Cabinet, he was responsible for freezing sales of JNR surplus land. *(Transportation News)*

Union members protesting in front of Tokyo Central Station in March 1977—a common scene during the latter JNR era. *(Transportation News)*

Therefore, it is the case that, while the start of the evaluation process will be to set the results against the targets (the explicit aims) laid out by the pro-privatization lobby, in my opinion, it is important to add further issues regarded as important tasks of the privatization—issues that I believe may reasonably have been viewed, at the time, as important objectives (the implicit aims) of any process of reorganizing JNR. Consequently, this analysis first sets out the stated objectives (the explicit aims) of the privatization and, second, sets out the issues (the implicit aims) that I believe should have been included in the original intentions. The analysis of the privatization 'results' will then deal with both sets of goals.

The Explicit Aims

- The former JNR Freight Division was to be privatized as a nationwide company, JR Freight, while the passenger operations of JNR were to be divided into six regional JRs. The geographical division of the JRs was related to the regional distribution of demand, and was designed to ensure a 'sound managerial base' for the new companies'(2).
- The created JRs were to be incorporated as joint stock companies and their stock sold to private investors as soon as possible after the establishment of a sound financial basis for their management. The business scope of the new JRs was to be as large as possible and, in order that they operate in the manner of privately-owned companies from the outset, the level of government supervision and control was to be reduced to the minimum 'that the situation permits'.
- A stable foundation for management was to be ensured by establishing special measures for profit adjustment between the new JRs. The profit adjustment provisions, involving correction of the imbalances in the profitability of the four existing shinkansen through SHC, subsidization of the JRs in underpopulated areas through the Management Stabilization Fund (MSF), and alleviation of the debt burden by its disposal to JNRSC with responsibility for future repayment, were aimed at the achievement of declared profits and avoidance of losses by the seven JRs.
- The number of personnel to be employed by the JRs was to be not more than that 'appropriate to the efficient conduct of their business'.
- The placement of former JNR personnel excess to the requirements of the JRs, and the disposal of the JNR indebtedness not transferred to the JRs was to be undertaken by the JNRSC.
- The disposal of the JNR debt was to be accomplished by selling the unused land assets and by listing the JRs' stocks.

These were explicit aims of JNR

Unused land on the site of Sasajima Freight Terminal, central Nagoya, still remains unsold today *(JNRSC)*

Table 1 Profits/Losses and Interest Payments of the Seven JRs, SHC and JNRSC (¥ billion)

Fiscal Year	1987		1988		1989		1990		1991		1992		1993		1994		1995		1996	
	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments	Profits/ Losses (▲)	Interest Payments (▲)	Profits/ Losses (▲)	Interest Payments (▲)	Profits/ Losses (▲)
Six Passenger JRs & JR Freight	339.3	156.0	362.2	220.9	288.0	289.9	240.3	303.7	547.8	307.1	822.0	236.2	780.1	224.4	725.8	142.1	730.4	219.6	n/a	236.3
Shinkansen Holding Corporation	604.8	1.8	589.5	9.5	564.1	15.6	552.5	14.9	275.3	▲150.1 1,041.5	—	—	—	—	—	—	—	—	—	—
JNR Settlement Corporation	912.6	▲2,315.2	1,059.6	▲1,780.7	1,074.9	▲740.1	1,055.2	322.9	1,064.4	561.8	1,050.8	▲482.2	1,007.2	173.6	954.6	▲956.8	943.5	▲993.3	n/a	n/a
Total	1,856.7	▲2,157.3	2,011.3	▲1,550.3	1,927.0	▲434.5	1,848.0	641.5	1,887.5	▲404.8 786.5	1,872.8	▲246.0	1,787.3	398.0	1,680.4	▲814.7	1,673.2	▲773.7	n/a	n/a

5-year Annual Average 1982–1986		5-year Annual Average 1987–1991		4-year Annual Average 1992–1995	
JNR		Seven JRs, SHC, JNRSC		Seven JRs, SHC, JNRSC	
Interest Payments	Profits/Losses (▲)	Interest Payments	Profits/Losses (▲)	Interest Payments	Profits/Losses (▲)
1,218.4	▲1,583.5	1,906.1	▲781.1	1,780.2	▲368.2

Notes: 1. The 1991 total includes the figures for SHC for 6 months until its dissolution on 30 September 1991
2. In 1990, JNRSC earned ¥882.2 billion from the sale of Teito Rapid Transit Authority shares
3. In 1993, JNRSC earned ¥1,075.9 billion from the sale of JR East shares.

(Source: Official Gazette)

privatization, as laid down at the time by its proponents. The further implicit aims which I previously mentioned as a basis for judging whether the process succeeded in changing the railway operations for the better are outlined below.

The Implicit Aims

In my opinion, the implicit aims of privatization were:

- The division and privatization would create a structure of nationwide railway operations that would effect a lasting improvement in the quality of service offered to the public.
- The privatized system would provide for sufficient long-term capital investment in the railway network.
- The framework of privatized corporations would establish the basis for a fundamental improvement in labour-management relations.

The Evaluation

Sound managerial basis

First, to deal with the explicit aims on which the JNR privatization was based, the initial objective was to establish a sound managerial base for the JRs. This was done by establishing JR Freight as a national freight corporation, and by forming six regional JRs for passenger operations. As evidenced by the financial results (Table 1) for these JRs, the privatization has been 'successful' in terms of consistent overall profits in the first 10 years.

Avoidable costs and subsidies

The simple conclusion derived from Table 1 is however open to challenge if one incorporates the following pre-conditions to the achievement of overall profitability across the JRs. First, it required that JR Freight be charged for its use of the rail network only on an 'avoidable-costs' basis, thus bearing only the marginal cost of accessing the track owned by the JR passenger companies. JR Freight remained broadly profitable in its first years only as a result of paying track-access fees at the avoidable-costs level; introduction of full costing would have turned the freight operation into a substantial lossmaker.

Second, the in-the-black position of the three island JRs (JR Hokkaido, JR Shikoku, and JR Kyushu) has been maintained by subsidies from the MSF. It is beyond the scope of this article to describe the operation of this Fund in detail, but several observations can be made. First, the Fund was created by increasing the debt burden inherited by JNRSC. Its existence to support the three inherently-unprofitable island JRs depended as much on public funds as would have been the case with the payment of normal subsidies.

Moreover, in practice, attaining the target 7.3% interest yield has been very difficult in a climate of consistently low interest rates. The recent introduction of a variant to the system, whereby the three island JRs have 'loaned' money to the

Railway Development Fund[3] (RDF), bears testament to the problems of making the MSF work sufficiently well to offset the operating losses of the regional railways. Under the new system, the three island JRs have consigned management of all or part of their funds in the MSF to the RDF which pays a higher rate of interest to the island JRs, effectively adding an additional subsidy to that established by the original MSF.

On the question of creating profitable JRs throughout the nation, it might be pointed out that, even taking into account the continuing need for subsidy (through the JR Freight avoidable-costs system and the MSF), the trend in profits achieved by the JRs has recently ceased to be consistently upwards (Table 1). Moreover, the current level of profits is substantially below the peak figures of the 1990–1991 period.

Relief from debt burden

Although some might argue that the separate creation of the JRs and the JNRSC eliminated the immense burden of the residual JNR debts from the JRs' balance sheets, it may be worthwhile to compare the overall results of all the new companies resulting from privatization. If one pushes the profitability issue to the logical conclusion—by consolidating the JRs' results with the JNRSC—it can be demonstrated (Table 1) that the aggregate losses are still substantial. The level of annual losses has fallen; the 4 Year Annual Average Loss has halved in the 1992–1995 period compared to that in 1987–1991, but the level of interest payments remains substantially higher than even in the latter part of the JNR era. The continuing generation of overall annual deficits, and the prevailing very high interest cost burden, are factors that should be considered in relation to the original explicit objective of establishing a 'sound managerial base'.

Liquidation of the residual debt held by the JNRSC was dependent on selling surplus land belonging to the former JNR and the listing of stocks in the JRs held by the JNRSC. The results in relation to this aim have not matched expectations. A detailed account of the land sale programme is not appropriate to this article, but suffice it to say that the disposal of the 'land bank' is well behind the original schedule, partly as a consequence of the government's reluctance to countenance early sales because of fears of fuelling a real-estate price boom, and will eventually generate much less than the ¥7.7 trillion targeted in the original privatization plans.

Table 2 Disposition of JNR Debt (¥ trillion)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Seven JRs	5.9	5.5	5.0	4.8	4.6	4.5	4.5	4.3	4.3	4.3
SHC Railway Development Fund	5.7	5.6	5.5	6.2	6.2	6.1	6.0	5.9	5.8	5.6
JNRSC	25.5	26.1	26.9	27.1	26.2	26.4	26.6	26.0	26.9	27.6
Total	37.2	37.3	37.5	38.0	37.0	37.1	37.1	36.3	37.0	37.5

Notes: 1. JR East, JR Central and JR West assumed a further liability of ¥9.1 trillion for the purchase of the four existing shinkansen from the SHC on 1 October 1991
2. The SHC assumed a long-term debt to the JNRSC of ¥2.9 trillion on 1 April 1987. This figure is shown here as part of the liabilities of the JNRSC. For details, see *The Privatization of Railways in Japan*, EJRCF, Spring 1995.

(Source: MOT and Transport magazine)

Listing shares

The share listings are similarly behind schedule, with only partial flotations achieved to date. The final receipts from the listings—which may remain incomplete—will bear very unfavourable comparison with the original targets set as part of the explicit aims.

The continuing delays in the share listings and the inability to sell the real estate have resulted in an increase in the scale of long-term debt (Table 2). The most recent plan to dispose of these long-term debts, drawn up by the Ministry of Transport (MOT) in August 1996, put the total figure at ¥28.3 trillion and it ac-

Double-deck trains on the Tokaido Trunk Line have eased commuting congestion *(K. Hata)*

Tsubasa mini-shinkansen on Yamagata Shinkansen *(JR East)*

Table 3 Domestic Passenger Transport by Mode

	Mode	JRs	Other Railways	Motor Vehicles	Aircraft	Ships	Total
1987	Volume[1]	204.7	140.0	718.5	38.5	5.9	1,107.6
	% Change[2]	+3.2%	+12.6%	+43.7%	+19.1%	+2.9%	+26.5%
	Market Share	18%	13%	65%	3%	1%	100%
1988	Volume	217.6	144.2	782.0	41.1	5.7	1,190.6
	% Change	+6.3%	+3.0%	+8.8%	+6.7%	-2.4%	+7.5%
	Market Share	18%	12%	65%	3%	1%	100%
1989	Volume	222.7	146.1	845.1	47.1	6.0	1,267.0
	% Change	+2.3%	+1.3%	+8.1%	+14.7%	+4.4%	+6.4%
	Market Share	17%	11%	67%	4%	1%	100%
1990	Volume	237.7	149.8	853.0	51.6	6.3	1,298.4
	% Change	+6.7%	+2.5%	+0.9%	+9.5%	+5.2%	+2.5%
	Market Share	18%	11%	66%	4%	1%	100%
1991	Volume	247.0	153.1	869.3	55.4	6.2	1,331.0
	% Change	+3.9%	+2.2%	+1.9%	+7.2%	-1.3%	+2.5%
	Market Share	19%	11%	65%	4%	1%	100%
1992	Volume	249.6	152.7	888.2	56.7	6.1	1,353.3
	% Change	+1.1%	-0.3%	+2.2%	+2.3%	-1.6%	+1.7%
	Market Share	18%	11%	66%	4%	1%	100%
1993	Volume	250.0	152.7	889.8	57.1	6.1	1,355.8
	% Change	+0.2%	0	+0.2%	+0.7%	0	+0.2%
	Market Share	18%	11%	66%	4%	1%	100%
1994	Volume	244.4	152.0	896.8	61.3	5.9	1,360.3
	% Change	-6.3%	-0.5%	+0.8%	+7.4%	-3.4%	+0.3%
	Market Share	18%	11%	66%	5%	0	100%
1995	Volume	249.0	151.1	917.4	65.0	5.5	1,388.0
	% Change	1.9%	-0.6%	2.3%	6.0%	-6.8%	2.0%
	Market Share	18%	11%	66%	5%	0	100%

(1) Billion passenger-km
(2) Over previous year

(Source: MOT)

knowledged that, whatever new measures are adopted to sell the former JNR assets, the residual burden on the Japanese taxpayer will be substantially higher than that envisaged at privatization. The original plan was for a residual debt of around ¥13.8 trillion after land sales and share flotations, but now more than ¥20 trillion is expected to be borne by the taxpayer. As an explicit objective, the disposal of the former JNR's indebtedness cannot be deemed to have been a success.

Quality of service

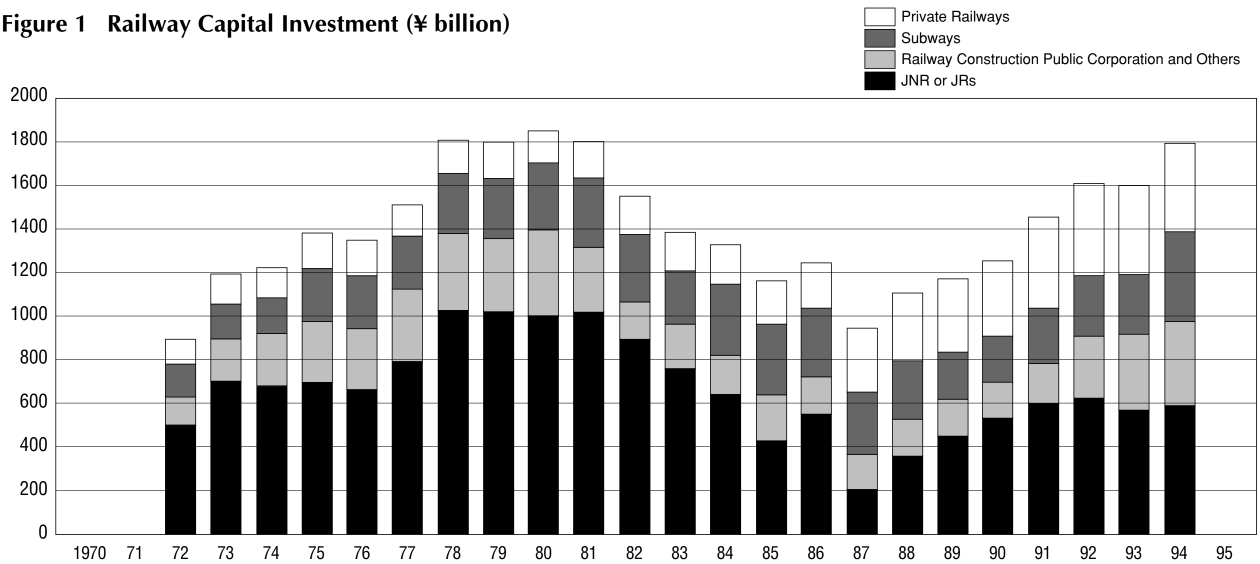
Next, to deal with what I believe were the 'implicit aims' of privatization. The first was to use the privatization measures to improve the quality of service offered by the JRs nationwide. 'Quality of service' is not an easily-quantifiable concept, but one potential measure is market share. The argument is that 'better' service would be reflected in better market share, since the improved service would generate additional business at the expense of other forms of transport. Table 3 shows that the JRs have achieved increased market share, especially in the early years after privatization. Hence, this might be construed as proof that the quality of service has improved since privatization.

Such a conclusion is supported by the following facts.

- No true fare increases for 8 years after privatization
- Introduction of new long-distance shinkansen services
- Conversion of exclusive freight tracks to passenger tracks for improved commuter services
- Increased frequency on commuter lines to compete with the private railways
- More flexible services to leisure areas (ski resorts, etc.)
- Better station facilities (increased numbers of escalators, upgraded toilets, more automatic ticket gates)

Privatization has clearly resulted in better services for customers, particularly

Figure 1 Railway Capital Investment (¥ billion)



Notes: 1. The figures for the subways are the amounts for developing the network. The other figures include replacement of worn out facilities and new construction.
2. Subway data is the total for Tokyo (including TRTA), Sapporo, Sendai, Yokohama, Nagoya, Kyoto, Osaka, Kobe, and Fukuoka.
(Source: Railway Figures, JTERC)

where the JRs are in direct competition with private railway companies. The competition aspect of privatization has benefited the consumer by stimulating the drive for greater efficiency.

While it would, therefore, be churlish to deny that there is evidence of 'better' service compared to the JNR era, consideration of another implicit aim—providing capital investment in the railway networks—does, however, temper the conclusion that privatization inevitably leads to improved service. Figure 1 shows the pattern of capital investment in the Japanese railway system before and after privatization. In the initial years after privatization, the JRs clearly reduced their capital investment to levels well below those prevailing in the JNR era. Although there has been some recovery in capital expenditure in recent years, the annual investment by the JRs still remains substantially below the peak JNR levels.

Management independence

The JRs have complained about what they see as an unduly high level of government controls on their operation. For example, the Minister of Transport retains the right to veto the appointment of JR presidents. However, the balance of power in important strategic matters such as major capital investment has swung towards the JRs. To borrow from *The Japan That Can Say No*, a book by Ishihara Shintaro on Japan/America relations, a new phenomenon of 'The JRs That Can Say No' has appeared. The epitome of this new government-JR relationship has been the funding for the new shinkansen which has resulted in the

Containers in JR Freight Tokyo Freight Terminal *(Transportation News)*

Tsubame Express on Kagoshima Line of JR Kyushu *(JR Kyushu Agency)*

JRs bearing only 50% of the construction costs as opposed to the 100% borne in the JNR era. Moreover, the JRs' 50% share is, in effect, being funded not by new additional liabilities, but by the proceeds from the annual sums already being paid by the three main-island JRs (JR East, JR Central, JR West) for the purchase of the 'old' shinkansen. Such a system would not have been countenanced in the JNR era, and its adoption clearly reflects the power of the JRs to say no to projects that are likely to result in lossmaking services.

Labour relations

Moving to the issue of utilising privatization to effect a lasting improvement in labour-management relations, a simplistic conclusion would be that the reduction in the level of industrial disputes in the post-privatization set-up proves that the new structure has been successful. In fact, this matter is connected to one of the explicit aims of the JNR privatization, namely, that the JRs should be obliged to employ only the number of staff considered 'appropriate for their operation'. At privatization, all JNR employees were dismissed and then most were hired by the JRs. But nearly 80,000 had to leave the railway and 10 years after the privatization, there is still a bitter ongoing dispute between some of the labour unions and the managements of the JRs regarding the criteria used to select employees. A judgment is pending by the Tokyo District Court, but whatever the verdict, the continuing dispute contrasts with the public image of an end to labour-management strife. Moreover, the unions at JR East, JR Hokkaido and JR Freight are following a different course to those at JR Central, JR West, JR Shikoku and JR Kyushu. Therefore, it appears to me that the present state of labour-management relations is more fragile than the surface view suggests.

Conclusion

With regard to the explicit aims, the creation of viable, profitable JRs has been accomplished, but with the aid of cross-subsidy of JR Freight by the passenger JRs, using the avoidable-costs mechanism, and with financial support for the three island JRs from the MSF.

With regard to the implicit aims, there is evidence of service improvements as a result of competition, particularly in commuter services, but the longer-term issue of the funding of future major infrastructure investment projects has not been resolved.

The changed balance of power between the government and JRs operators in favour of the latter has enabled the JRs to refuse unprofitable investment projects, and to critically examine services (such as in rural areas) that are hard to justify on strictly financial grounds.

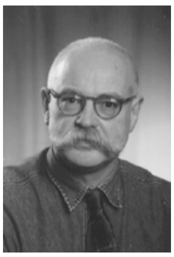
My original verdict 5 years after the privatization that it was a major political triumph is not diminished by this new analysis. However, the problems that existed then are still unresolved. The immediate key issues are the continuing substantial residual JNR debt, which threatens government finances, and the difficulty of funding major railway capital investment projects, affecting the future quality of the rail network. Future areas for concern are the unresolved labour-management issues, the potential for fare increases, and the prospect of the closure of unprofitable lines, affecting rural rail services. ■

Notes

(1) The Privatisation of the JNR in Historical Perspective, PhD Thesis, Stirling University, Scotland.

(2) All quotes in this article are taken from *Kokutetsu kaikaku ni kansuru iken* (Opinions on the restructuring of JNR), a report of the Supervisory Committee on the Restructuring of JNR.

(3) The Railway Development Fund was formed to support investment in railways when the assets of the Shinkansen Holding Corporation were sold. For an in-depth description, see *JRTR* 11, pp. 14–17.



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