20 Years After JNR Privatization

A Bird's-Eye View of World Railway Reform Trends

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Impact of 1987 Japanese Rail Reform

When the radical reform of the deficit-ridden Japanese National Railways (JNR) took place in 1987, I was stationed in Paris representing JNR to European countries. The main feature of this reform was geographical division of the nationwide rail network and 'privatization' of each new railway. I still clearly remember how Europeans, including railway professionals and scholars, first reacted to this reform half in doubt. Although it was called 'privatization', all shares in the new rail companies were owned by the government. So, in the strict sense of the word, it should have been called 'corporatization' instead of privatization. However, the promoters of the Japanese rail reform preferred to use the term 'privatization' from the very beginning, in order to eliminate political interference with railway management and to restore healthy industrial relations with trade unions as quickly as possible. Without knowing the political and socio-economic backgrounds in Japan at that time, it was not easy to understand why the Japanese reformers so hastily gave the name of privatization to the premature reform.

Crowded South Gate of JR East Shinjuku Station, Japan's busiest station with 1.5 million passengers every day.
(Author)

However, the three major passenger rail operators on the main island of Honshu (JR East, JR Central and JR West) soon started to show much better business results than expected, and they finally achieved true privatization by listing all their shares on the stock exchange. Consequently, the 1987 rail reform as a whole has been regarded as a great success. This 'success' has also been recognized outside Japan, and has drawn attention from many developing countries and former socialist countries that are under heavy pressure to improve their railways' financial performance. However, although many people believe that the 1987 rail reform was a success, it is only the three major passenger companies that achieved true privatization; the other three passenger companies (JR Hokkaido, JR Shikoku and JR Kyushu) and the freight company (JR Freight) still fall far short of true privatization. These smaller companies only narrowly avoid falling into the red, thanks to a complex financial support system.

Market–Key to Success

The privatization of the three major passenger companies in Japan succeeded simply because they are favoured by a very good market: extremely dense population along a long corridor. Such a market does not exist everywhere, and even in Japan, the railway faces difficulties on the smaller and less-populated islands of Hokkaido, Shikoku and Kyushu. The freight railway in Japan also has difficulties due to severe competition with road and sea transport and the scarcity of rail-oriented bulk goods, such as coal.

Generally speaking, there are only few examples of lucky railways that can run independently bearing expensive infrastructure costs. Such exceptional examples can be seen in freight railways in North America and passenger railways on Honshu, Japan. Although the North American freight railways and the Japanese passenger railways look very different in external appearance, they share very similar financial structure as private enterprises. Almost all other railways in the world cannot run without some kind of financial support from public funds. There are many countries in the developing world that are pursuing radical rail reform including privatization, but in most cases, the slogan of 'privatization' means abandoning the government's responsibility to railways. In such countries, it is also very difficult to diversify the railway's commercial activities by developing non-railway businesses, and to provide new jobs to the redundant railway workers.

Although the current Japanese railways show two different aspects, i.e. the prosperous three major passenger companies and the four other companies struggling for existence, the success of the former group is too much highlighted and the difficulties of the latter are too often neglected.

Investment–Another Key to Success

Another important factor that was essential to the success of the three major passenger railways in Japan, was the fact that the JNR maintained a very high level of investment despite heavy financial burdens. As a result, JNR's infrastructure and rolling stock were maintained in fairly good condition. JNR's investment depended heavily on loans from government and private financial institutions, and the interest from loans accumulated enormously toward the final stages. For this reason, investment was often regarded as one of the main causes of JNR's financial collapse, and I admit that there were some examples of unnecessary or excessive investment, such as double-tracking of not-so-busy lines, etc.

However, I believe that JNR's investments were in most cases necessary and useful for the future of the railway. This is proven by the fact that the newly founded JR companies have saved a lot of money so far, by limiting their investments to the lowest level. Had it not been for the high-speed shinkansen network reaching 1800 km and improved urban and suburban network, the 1987 reform could not have brought success, even to the three major passenger railways.

We see another extreme in Britain, where the former British Rail (BR) left a very small amount of long-term debts with terribly deteriorated infrastructure and obsolete rolling stock. The technical conditions of a railway cannot be judged properly by using financial statements, because the amount of long-term debts and soundness of fixed assets, such as infrastructure and rolling stock, are often closely related to each other. The underlying problem is that railways in a competitive market cannot raise investment funds through their commercial operations, although investments are vital for their survival. Both Japan and Britain failed to demonstrate an ideal answer to this serious question.

Is Japan a Good Model?

As explained before, the 1987 Japanese rail reform was exceptional in many senses. It was favoured by a good passenger market and helped by heavy investments by JNR. The so-called 'bubble' economy from the late 1980s to the early 1990s was also a strong tail wind for the new railway companies. But it should also be noted that heavy cross-subsidization still exists in the three major JR companies, which cover enormous losses from rural services with profits from shinkansen and urban operations. This is a potential threat to the future of railways, because unprofitable rural lines are maintained by the sacrifice of funds earned from profitable high-speed or urban lines. To improve the competence of rail services, such funds should be preferentially used for investment on profitable lines.

Ruin of a station of former JNR Shihoro Line in Hokkaido, which was closed at 1987 rail reform due to low traffic. (Author)

Apart from the cross-subsidization within the three major JRs, there are also complicated and expensive financial arrangements to save the smaller JRs: the so-called Management Stabilization Fund was created to cover the operating losses of JR Hokkaido, JR Shikoku and JR Kyushu. JR Freight is paying only marginal infrastructure costs for track usage, while most lines are owned by the passenger companies.

Under such circumstances, we have to raise one fundamental question: can the Japanese rail reform be regarded as a truly good model for developing countries? To answer this question, we need a general view of railway reform trends in the world.

European Rail Reforms

Soon after the Japanese reform, in 1988, Sweden started a unique reform that featured separation of rail infrastructure from operations. Sweden's new policy was soon adopted by the EC and the famous directive 91/440 EEC was proclaimed in 1991, although Sweden was not a member state of the European Community (now European Union) at that time. The new European policy was characterized by two elements, separation of infrastructure from railway operations, and so-called open access to rail infrastructure.

The European rail reforms seem to be a very long process, with big variety from one country to another. The separation of infrastructure has been achieved in all countries although signs of reluctance to complete separation are seen in France and Germany. There has been no privatization except in the Britain, where the excessive splitting-up of BR and the hasty privatization is now generally regarded as a failure. The European reforms emphasize the importance of on-rail competition, expecting new rail operators to come into the market, but the progress so far has been slow with only a few significant new entrants.

It seems that the European policymakers regard separation of infrastructure as essential to enhance on-rail competition between different rail operators. However, there are two fundamental questions concerning this policy. One is that the railway's future growth heavily depends on the technical developments covering the interface between infrastructure and rolling stock. Key issues for the railway's future, such as high-speed running, energy saving, lessening noise pollution and minimizing total operation and maintenance costs, can only be solved by joint efforts of infrastructure and rolling-stock managers, and the current European arrangements make it more difficult to put them together.

The other question is that the current European system clearly lacks the economic incentive that makes infrastructure companies work hard to improve tracks, structures and buildings. To provide better railway services, so-called on-rail competition is not sufficient, and at least some reasonable coordination between infrastructure companies and train operators is very necessary, but there is no built-in mechanism to assure such arrangements.

Concessions in Latin America

In parallel with Japan and Europe, another type of rail reform took place in Argentina under the guidance of the World Bank. The reform was characterized by what is called 'concession', meaning partial transfer of rail operations from the government to private operators over some period of time. This type of rail reform soon spread widely in Latin America, presenting marked contrast to the European reforms characterized by 'separation of infrastructure from operations' and 'open access to infrastructure' as well as to the Japanese reform characterized by 'geographical division' and 'privatization'. It seems that the rail reform in Latin America succeeded in cutting costs and in improving management efficiency, but it has brought inevitably drastic cuts of unprofitable services.

20 Years After

Almost 20 years have passed since the 1987 Japanese rail reform. For my generation, however deficit-ridden and ill-fated, JNR was a reality in which many people worked together, sharing joys and sorrows. But for today's university students, it is a historic entity that has never existed in their real life. Looking back at Japan's railway history, we find that the basic management structure of railways has changed about every 40 years—the coexistence of government and private trunk lines from 1872 to 1906, the monopoly of the government railways from 1906 to 1949, the failure of JNR as a state-owned corporation in adapting itself to an increasingly competitive transport market from 1949 to 1987. We do not know whether history repeats itself or not, but if it does, 20 years means that the current system is now moving into the second half.

Now is probably the right time to make a correct evaluation of the merits and demerits of the 1987 rail reform in Japan, including comparative studies with railway reforms in other countries. It should also include a fair analysis of JNR's failure, which is the prehistory of the current Japanese system. In my personal view, more practical lessons for railways abroad can be drawn from the failure of JNR rather than from the success of the three major JR companies.

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