Achievements and Issues of Railway Management

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Introduction

Has the 1987 breakup and privatization of the old Japanese National Railways (JNR) been a success? There is no telling how many times this question has been asked in the 25 years since JNR became the group of six independent regional passenger operators, and the nationwide freight operator, Japan Freight—loosely called the JRs today. However, nobody has yet to answer the question, which may itself fall into the category of nonsense. The paths that the JRs have taken in their first 25 years and their varied achievements are complex, making a clear black-and-white judgment impossible.

At the very least, we can say that the JNR breakup and privatization has probably been a relative success because without it the management's achievements would be poorer than those of the JRs. Moreover, railway transport in Japan would be in dire straits now.

But has the JNR breakup and privatization been a success in the absolute sense? This article looks at the achievements of the JRs over 25 years and discusses their future issues. Due to space limitations, however, this will only cover the surface of the topic.

JR's Management Achievements and Background

A lot of data can be (and has been) presented showing that the JNR breakup and privatization was a success. Such data includes improvements in the overall account balance of JR companies, increased productivity as the result of reduced workforce (460,000 in 1965 to 201,000 at the start of JRs in 1987), and controlled fare increases in JRs' passenger companies. However, it is not an easy task to simplify the factors behind every item of data but focusing on the breakup brings some into perspective.

The economic theory of industrial organization often analyzes the border between a company and its market, or the optimum company scale. Increases in scale may create 'economy of scale' whereby increasing the scale of a company reduces unit production costs. (This differs from cost reduction due to mass production at a given scale.) Economy of scale is said to be easy to achieve, particularly in process industries, such as railways.

However, if the company scale becomes too bloated, transmission of information and communication within the organization no longer runs smoothly–objectives cannot be shared, and the organization as a whole may no longer work efficiently. In economics, we say the 'transaction costs become large'. Ultimately, the optimum company scale is thought to be determined by the balance between cost reduction through economies of scale and increases in transaction costs due to expansion of the organization. (Of course, there are other analytical approaches.)

The scale of a purely private company is determined automatically by the decisions of the company's management. However, JNR could not determine its own scale because the management decisions were greatly affected by political intervention and the organization became bloated. Seen from this viewpoint, the reduced scale of the six new JR passenger companies resulting from the breakup is, to some extent, appropriate. However, serious consideration is needed to determine whether the scale of JR Freight is appropriate for current business conditions.

So, what about the JNR 'privatization?' We can say that sufficient stimulus was given to the new JR companies for them to realize they are in the midst of severe competition, and they probably have been given sufficient management freedom. Strict government administration in the JNR era, as demonstrated by legislative control of fares, inevitably provided fodder for political fights and was used for political purposes. Just as the proposal to eliminate expressway tolls is being used in political fights in Japan today, politics played a major role in JNR operations. Eliminating constant political intervention was a major achievement of privatization.

If the new JRs had continued to be reliant on government, today's success would probably not have occurred. Innovation occurs in both intangible and tangible ways. A good idea like Shonan-Shinjuku Line trains sharing the track of a relatively empty freight line as a means of running more than one passenger line instead of having their own dedicated track, would probably never have been achieved by the old JNR due to conflicts of interest among the various parts of the railway administration.

Companies also pursue economies of scope while they

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pursue economies of scale. Economy of scope means, for example, using the assets of the main business for services in other fields to reduce overall costs. For the JRs, economies of scope in railway-related business fields were made easier by privatization. A typical example is building shopping spaces called *ekinaka* inside the ticketed area. NEWDAYS, JR East's well-known convenience store chain run by JR East Retail Net Co., increased the number of shops from 226 to 432 during the last decade. The idea of using stations as venues for consumption instead of just for moving passengers as well as the lack of restrictions preventing such business expansions has made the ekinaka project very successful.

There are many other factors requiring analysis, such as reform of labour relations and relations between unions, unbundling of long-term debt, and the presence of the Management Stabilization Fund (MSF, a fund established by the government to compensate for expected financial losses of the less profitable JR Hokkaido, JR Shikoku and JR Kyushu), but they are too numerous to mention.

Issues after JNR Breakup and Privatization

Although already a well-known fact in 1985, the *Kokutetsu Kaikaku ni Kansuru Iken* (Opinions on Restructuring of JNR) report by the Supervisory Committee for JNR Reconstruction makes no mention of Japan's declining birth rate and greying society. Such changes in Japan's social environment were probably not seen as a serious problem back then. Or possibly there were other serious problems that outstripped recognition of this issue by JNR at the time. In either case, such changes in the social environment were seldom noted at the JNR division and privatization. As a consequence, the new JRs are being forced to deal with this social environment today.

What is now seen as a serious problem in this perspective is the widening management gap between the three JRs on the main island of Honshu (JR East, JR West and JR Central) and the three companies on the three smaller islands (JR Kyushu, JR Shikoku and JR Hokkaido). Since regional lines take the early brunt of the declining birth rate and greying society through depopulation, JR Kyushu, JR Shikoku, and JR Hokkaido are now facing management crises. The MSF plays an important role in supporting their managements today, but neither JR Hokkaido nor JR Shikoku can be supported by the MSF alone when looking at their recent profit and loss statements. In the FY2010, JR Hokkaido registered an operational loss of ¥28.475 million while the return from the MSF was ¥24,089 million, and JR Shikoku registered an operational loss of ¥9322 million while the return from MSF was ¥7490 million. The previous section presented a relatively positive assessment of the scale of the JRs. Considering the declining birth rate, greying of society and repercussions on depopulated regions, we may have come to the point where we need to reflect on whether it was a good idea to break up JNR into regional JRs based on geographical and political lines.

Note must be taken of the three JR companies on Honshu that seem at first glance to have stable management.

The declining birth rate and aging society not recognized at JNR's division and privatization is having serious implications for the JRs' managements today. (The Transportation News)

The JRs constantly face the danger of political intervention such as over new shinkansen lines. (The Transportation News)

We need to recognize that the current management situation is a management accomplishment as a result of unbundling long-term debt. The companies did assume a part of the debt, but the greater part of ¥31 trillion was taken over by the state-owned JNR Settlement Corporation (JNRSC). This is the greatest reason why we cannot judge the JNR breakup and privatization to be an absolute success and not just a relative success, because the long-term debt from 25 years ago has simply been 'bottom-drawered'. When the JNRSC was dissolved in 1998, the JNR's remaining long-term debts were partly exempted but mostly assumed by the government's general account. The public has for the most part forgotten it, but this negative legacy needs to be re-acknowledged.

When JNR was divided and privatized 25 years ago, Japan had not yet reached the height of its economic 'bubble' and land prices were still increasing. Except for a handful of experts, few people recognized that Japan was even in a bubble, which was only recognized when it burst. Consequently, *Opinions on the Restructuring of JNR* did not explicitly recognize the bubble. The Supervisory Committee assumed that debt would be repaid easily by selling unwanted land assets at rising prices. The collapse soon after the formation of the JRs put these debt repayment estimates into disarray. Worse, government policy intentionally restricted the sale of assets at the peak of the bubble. While unthinkable for a private company, government control of asset sales meant that the best timing was missed, creating an unfortunate situation in long-term debt terms, although selling off the assets might have resulted in a more severe situation for the post-bubble Japanese economy. We must remember that the JNR's long-term unpaid debt still squeezes Japan's finances.

Future of JRs

It goes without saying that the JRs must make further management efforts to maintain and grow their businesses. Having achieved complete privatization, the three larger JRs on Honshu have appropriate oversight by shareholders and the market, indicating that the management efforts are working to some extent. The three smaller island JRs are still wholly owned by the government, and for this reason they are still bound by business law regulations. Even so, they seem to have a degree of management autonomy.

Sorting out points that are difficult for the JR companies to overcome under their own management efforts will probably be meaningful in gaining an outlook for the future of the JR companies.

The first point is securing an environment of fair competition.

The government trial last year with a ¥1000 unlimited distance weekend toll on expressways and other trials on eliminating tolls altogether greatly disrupted competition between road and rail. The measures were implemented at the end of the Liberal Democratic Party administration and in the early days of the Democratic Party of Japan administration. Ingenuity and efforts to provide lower fares and better services in inter-urban air and rail transport must not be lost by implementing an expressway toll system warped by massive infusion of public money (the government allocated ¥100 billion in the FY2010 budget). The suspension of expressway tolls in the Tohoku region struck by the great earthquake, tsunami and nuclear disaster in March 2011 was unavoidable to some extent, but extended implementation of such measures needs careful consideration as discussed in my other articles included in the reference materials section.

Second is securing fair burden. Noting just one of many key points here, ridership of rural lines has dramatically decreased, and a major role many of those lines play today is that of transporting students to school. However, usage by students commuting to school is with season tickets at a substantial discount, and the loss from that discount is financed by cross-subsidization from other passengers. Since education has external nationwide benefits, the cost should be borne reasonably by the nation as a whole. Rail operators carrying the costs of government policy such as student discounts is not a fair burden. The same can be said for discounts for the disabled. It is important to improve the three island JRs' management conditions by correcting such unfair burdens, even if the benefit is not so large.

Third is elimination of unreasonable political intervention. Blatant political interventions, which were often seen in the JNR era, are no longer seen today, but the JRs constantly face potential threats. Eliminating inappropriate intervention and securing autonomy at the discretion of rail operators will continue to be important.

Conclusions

We can see there have been relative successes as we mark the 25th anniversary of the formation of the JRs, but it is difficult to say whether they have been absolute successes. There are many issues to analyze and radical social changes make analysis of the JRs' path even more difficult. At the 50th anniversary, I hope to be able to say they have had more successes than at the 25th anniversary. ■

This article and photographs were originally published in Japanese in the May 2012 edition of *Han Kotsu* published by Japan Transportation Association.

Further Reading

Supervisory Committee for JNR Reconstruction, '*Opinions on the Restructuring of JNR – To open the Future for Railways*', 1985

Kenzo Takeuchi, 'Toward Risk Management and Restoration after Great East Japan Earthquake: From a Viewpoint of Economics', *IATSS Review*, Vol. 36, No. 2 (Oct. 2011), pp. 113–119

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