

Assessment of Success of 1987 Railway Reforms and Future Issues

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Introduction

Japanese National Railways (JNR) was divided and privatized into six passenger operators and one freight company in April 1987 just as I was entering high school, but I remember it like yesterday. Although feeling uncomfortable with the new 'JR' group name and logo, I was excited about the big changes soon to happen.

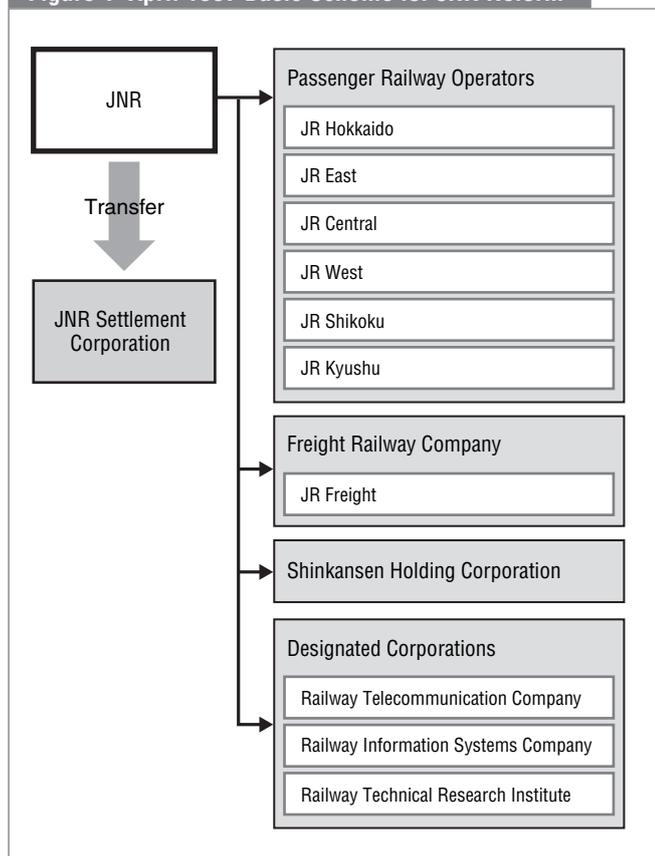
This April marked the 25th anniversary of those reforms, said to have been the greatest administrative feat since the end of World War II. The intervening 25 years have witnessed the bursting of Japan's economic bubble and the subsequent long-term recession, as well as changes to the socioeconomic structure starting with the global financial crisis in the USA. In the midst of these upheavals, the seven

JR companies created from JNR have put great effort into their businesses.

The three JRs on Honshu—JR East, JR Central, and JR West—have seen growth in revenues from railway business centred on shinkansen and expansion of businesses through diversification. On the other hand, the three JRs on the smaller islands—JR Hokkaido, JR Shikoku, and JR Kyushu—have worked to stabilize their management by using investment income from the Management Stabilization Fund, and maintain daily rail services in provincial areas. The freight volumes hauled by JR Freight are linked closely to economic conditions, and the company has had difficulties balancing income and expenditure in the long-term recession, but the company has played its role in handling the national policy of a modal shift in freight transport from road to rail.

This article looks back at the past 25 years to assess the JNR reforms and remaining future issues.

Figure 1 April 1987 Basic Scheme for JNR Reform



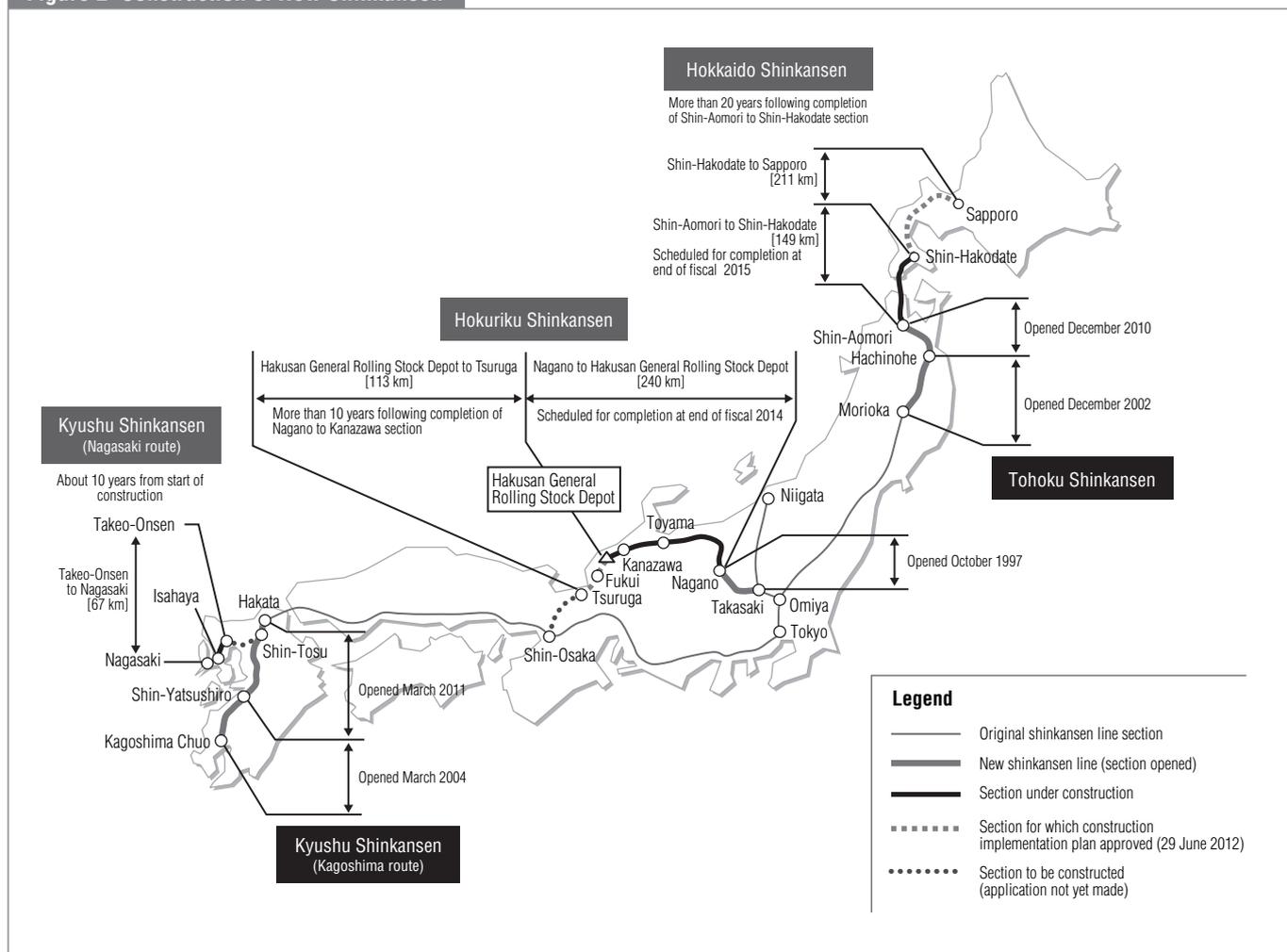
Changes in 25 Years

Revitalization of railway business

The major significance of the JNR division and privatization was the intent to change the bankrupt JNR into businesses that could handle severe competition in the transport market and would reinvigorate the railway business so railways could continue to remain important in peoples' daily lives. From this viewpoint, some specific results of the 1987 reforms have been:

- **Maintenance of fares**
After 1975, annual fare increases were the norm in the JNR era, but since the privatization in 1987, the three JRs on Honshu have only increased fares once in 25 years when a national consumption tax (VAT) was introduced. The three smaller JRs increased fares once in 1996, but have not increased them since. For the most part, fares have been maintained at pre-privatization levels, and differences in fares from large private railways have mostly been eliminated in urban areas.

Figure 2 Construction of New Shinkansen



• **Improved quality in railway services**

After privatization, the JRs soon started looking at how to improve the quality of railway transport. Schedules were improved and new or modified rolling stock was introduced, often tailored to specific regional needs. The JRs worked on increasing speeds to make the most of rail's speed characteristic. They improved customer interaction, which is a key foundation of a service industry like rail. The combined effect of these changes has been better convenience for rail users.

• **Increased tax payments**

The birth of the new JRs as private corporations led to the payment of national taxes, such as corporate tax, and local taxes, such as property tax. Tax holidays, etc., on property taxes were approved for JR Hokkaido, JR Shikoku, JR Kyushu, and JR Freight due to their business situations. However, JR East, JR Central, and JR West have seen good business results, and the amount of taxes they pay has increased year after year. In FY2011, the seven JRs paid ¥194.5 billion in taxes.

• **Increased productivity**

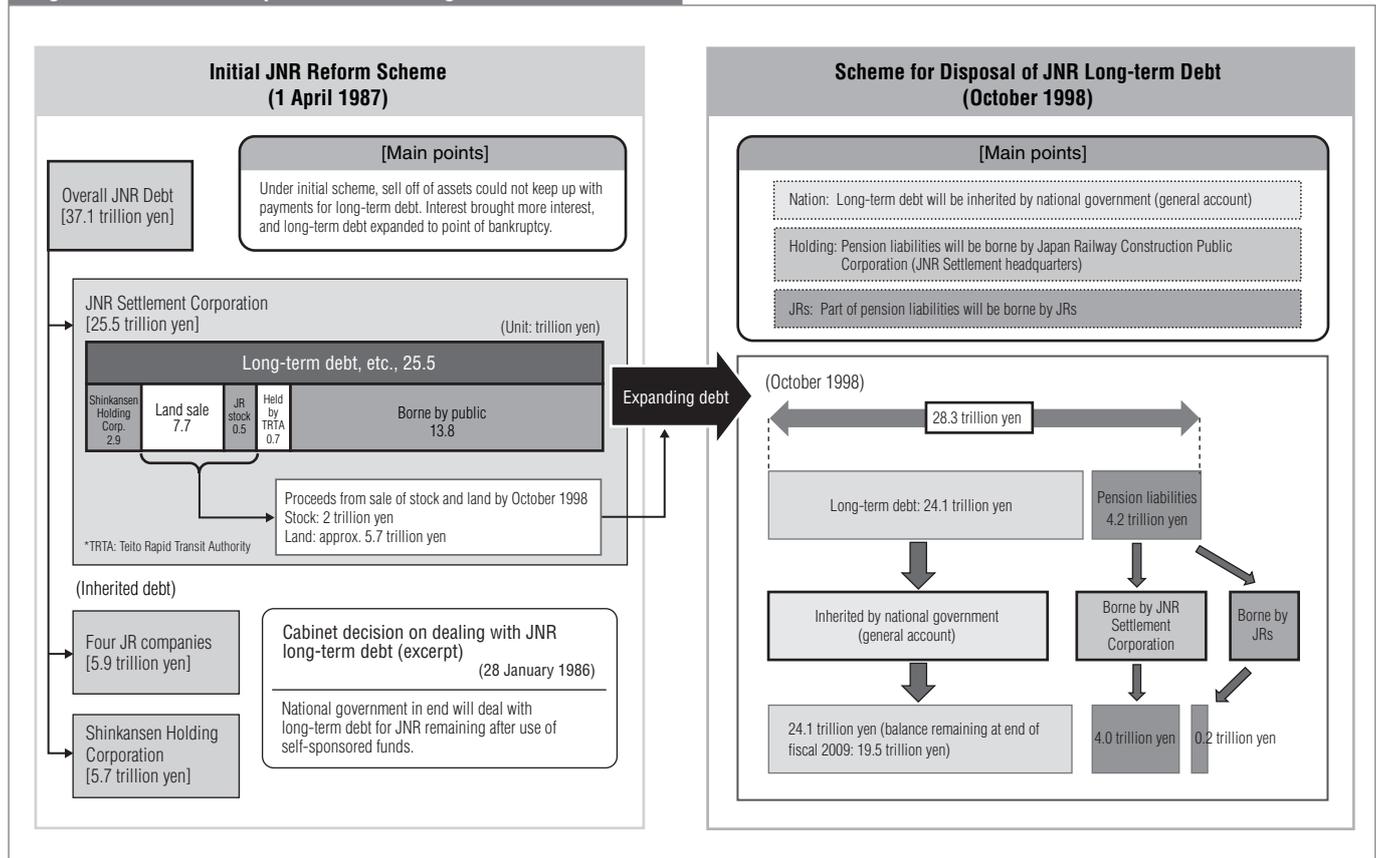
JNR had some 387,000 employees when the decision to divide and privatize was announced at the end of FY1982; this had been cut to 199,000 at the beginning of FY1987—the first year of the seven JRs. By the end of FY2011, the number had decreased again to 125,000, indicating the improvement in labour productivity.

• **Upgraded shinkansen services**

Shinkansen improve the convenience of railways in Japan. At the 1987 reforms, management of the Tokaido/San'yo, Joetsu, and Tohoku shinkansen opened during the JNR era was taken over temporarily by the Shinkansen Holding Corporation which then sold the lines to the individual JRs in 1991. Each operator has been working to improve services by increasing speeds and improving timetables.

The Japan Railway Construction, Transport and Technology Agency (JRJT) financed, built, and lease the Hokuriku, Kyushu, and Tohoku (Morioka to Shin-Aomori) shinkansen opened since 1987. The JRs lease

Figure 3 Status of Disposal of JNR Long-term Debt at 1998



new shinkansen from the agency, and construction of new sections has proceeded slowly so as not to place excessive lease burdens on the JRs. The opening of the Kyushu Shinkansen (Hakata to Shin-Yatsushiro) finally connected Aomori in northern Honshu to Kagoshima in southern Kyushu by shinkansen.

Business Diversification

Before 1987, JNR's business was limited strictly to railways. However, after 1987, the new JRs faced no limits on their business range, opening the road to diversification.

Soon all six JR passenger operators had started so-called *ekinaka* business using space inside the ticket wickets for commercial purposes. They have developed business in fields including shopping centres, office buildings, hotels, advertising and printing. Services utilizing IC card e-money have also expanded, providing a large source of income.

As Japan's population starts dropping, future income from railway transport will drop too while the proportion of income from these diversified businesses is expected to increase.

Handling of Long-term JNR Debt

At the end in 1987, JNR had some ¥37.1 trillion in accumulated debts. JR East, JR Central, JR West, JR Freight,

and the Shinkansen Holding Corporation took over ¥11.6 trillion of this debt burden and the remaining ¥25.5 trillion was inherited by the JNR Settlement Corporation (JNRSC). The intent was to repay the JNRSC debt by selling unused JNR land and stock in the new JR companies. However, the plan did not raise as much as expected due to postponed land sales when the country was experiencing a land price bubble, and delays in market listings due to a poor stock market. Consequently, the original scheme of paying annual interest while redeeming the debt failed.

As a radical measure to handle the debt, the 'Act on Treatment of Debt, etc., of the JNR Settlement Corporation' was passed in October 1998. By this time, the original JNRSC debt of ¥25.5 trillion had grown to ¥28.3 trillion due to interest and ¥24.1 trillion was taken over by the government general account; ¥4.2 trillion of pension burden was excluded. As a result of these measures, the amount of long-term debt is being reduced gradually. At the end of FY2010, the debt inherited by the general account had decreased to ¥19.1 trillion.

Full Privatization of Three JRs on Honshu

Initially, all shares in the seven JRs were held by JNRSC but they were handed over later to JRJT. The shares in the JRs on Honshu were sold first. The JR East shares were sold

Table 1 Status of Sale of Shares of Three JRs on Honshu

	Shares held at start by JNR Settlement Corporation (thousands of shares)	Sales completed		
		Shares sold (thousands of shares)	Income from sales (¥ billion)	Date of sale
JR East	4000	2500	1075.9	October 1993
		1000	652.0	August 1999
		500	266.0	June 2002
JR Central	2240	1354	485.9	October 1997
		600	477.0	July 2005
		286	329.0	April 2006
JR West	2000	1366	487.8	October 1996
		634	260.7	March 2004
Total	8240	8240	4034.3	—

in October 1993, followed by JR West in October 1996. JR Central shares were sold in separate tranches between October 1997 and April 2006.

The 1986 Law for Passenger Railway Companies and Japan Freight Railway Company (JR Law) still gave the government some control over the new companies. For example, the Minister of Land, Infrastructure and Transport had to authorize capital borrowing, annual business plans, etc. The 2001 revisions to the JR Law exempted the three JR companies on Honshu from these government controls, making them fully privatized companies as first intended. As private companies, they gained freedom and proceeded with independent management.

Labour problems

The 1047 employees who opposed the JNR division and privatization were made redundant by JNRSC but they waged a long campaign to be rehired by the JRs. The government made efforts in employment measures such as those based on the 'Law Concerning Special Measures for Promoting Re-employment of JNR Personnel Wishing to Leave JNR and JNR SC Personnel'. However, most of the 1047 people continued civil suits against JRJT, seeking compensation, employment, pensions, and the like.

In June 2010, the government accepted the request for a political settlement of the remaining 1047-person issue, prompting a judicial settlement between 904 plaintiffs and JRJT.

The National Railway Workers' Union—to which most of the 1047 people belonged—declared at its July 2011

national conference that the problem of non-employment was concluded. The Supreme Court is finalizing its decision on the remaining few who continued litigation, showing that progress is being made towards settling the issue after 25 years.

Future Issues

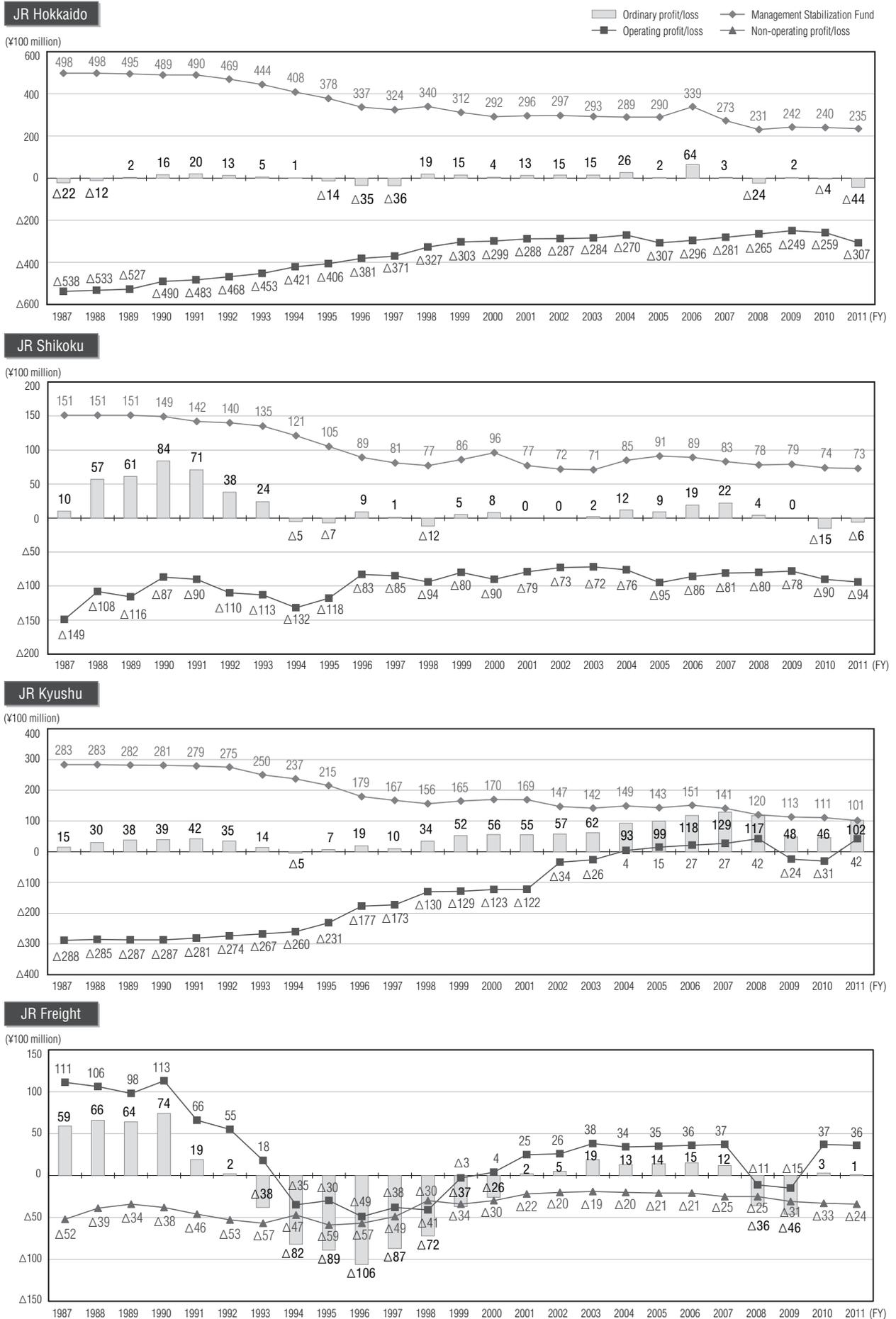
The last 25 years have produced many good results, but some issues still remain. While the three JRs on Honshu are fully privatized, JRJT still holds all the shares in the three island JRs and in JR Freight. The most pressing issue is how to stabilize the business of these companies and achieve full privatization.

Efforts are also needed in maintaining loss-making regional lines. While the JRs have managed to keep many open, declining population makes this harder with time.

Unlike the large JRs on Honshu, the bulk of the business of the three smaller island JRs is intra-regional transport. Since it was realized that these JRs would have difficulties balancing revenues against costs, they did not bear any of the JNR long-term debt burden when formed. Instead, a Management Stabilization Fund totalling ¥1.3 trillion was setup to yield interest that would offset business losses.

Today, the number of railway users continues to decline on all lines nationwide due to falling population and build-out of the expressway network. To make business more difficult, the fund yield has dropped from 7.3% at the outset to about 3.2%. Both trends are expected to continue, and the managements of the smaller JRs face a difficult situation.

Figure 4 Change in JR Hokkaido, JR Shikoku, JR Kyushu, and JR Freight Ordinary Profit/Loss



JR Freight started business as a unified nationwide freight transporter, and inherited part of JNR's debt. The business boom in 1987 helped sustain initial profits for a few years but the continuing long-term recession and drop in transport volumes after the bubble burst means it now faces a difficult management situation. The balance of long-term debt continues to increase despite management efforts to cut costs.

In this situation, the 'Act on Treatment of Debt, etc., of JNR Settlement Corporation' was revised in 2011 to allow the government to provide support. The Management Stabilization Fund was augmented, and JR Freight and the island JRs were given access to retained earnings held in the JRTT special business account; support for capital investment was also given. The government is providing strong management supervision and it is hoped these companies will become more self-reliant in the future.

The future issues for each smaller JR and JR Freight are summarized below.

JR Hokkaido

JR Hokkaido mostly operates loss-making regional lines. The management continues to face a difficult business situation

due to factors such as decreasing population and expansion of the expressway network.

The company needs to work on safety measures as a top priority following their responsibility for last year's derailment on the Sekisho Line.

In another development, the Hokkaido Shinkansen (Shin-Aomori to Shin-Hakodate) is expected to open in late FY2015 and the company needs to create a set-up that can increase profits using the effects of the shinkansen.

JR Shikoku

Like JR Hokkaido, JR Shikoku mostly operates loss-making regional lines. And again, management continues to face a difficult business situation due to factors such as decreasing population and expansion of the expressway network. A unique issue faced by the company is increased competition from automobiles if road tolls on the Honshu-Shikoku bridges are lowered. Together with the local population, JR Shikoku must study how to counter the effect of such measures.

In any case, the management needs to be made more efficient and self-reliant by using financial support from JRTT effectively and going forward with necessary capital investment.

Figure 5 Support for JR Hokkaido, JR Shikoku, JR Kyushu, and JR Freight

Act for Partial Amendment of the Act on Treatment of Debt, etc., of JNR Settlement Corporation
(Passed 8 June 2011, Promulgated 15 June 2011, Enforced 1 August 2011)

Take necessary actions regarding stabilization of JR Hokkaido and JR Shikoku management, support for capital investment of JR Hokkaido, JR Shikoku, JR Kyushu and JR Freight, steady construction of new shinkansen, and support for conventional lines parallel to shinkansen lines in order to utilize retained earnings of the Japan Railway Construction, Transport and Technology Agency's special business account for promoting railway policy.

1. Augmentation of Management Stabilization Fund for JR Hokkaido and JR Shikoku (by interest-free loan)

To stabilize management of JR Hokkaido and JR Shikoku, the agency shall be able to issue special bonds for those companies with a redemption period of 20 years at an interest rate determined by the Minister of Land, Infrastructure and Transport, taking into account market rate trends and other considerations. In that case, the agency shall be able to make interest-free loans to those companies to cover expenses required for underwriting special bonds.

- JR Hokkaido: 220 billion yen (special bonds issued on 16 December 2011)
- JR Shikoku: 140 billion yen (special bonds issued 29 November 2011)

2. Support for Capital Investment of JR Hokkaido, JR Shikoku, JR Kyushu, and JR Freight (Fiscal 2011 to 2020)

The agency shall be able to issue subsidies and make interest-free loans to JR Hokkaido, JR Shikoku, JR Kyushu, and JR Freight to cover expenses required for capital investment of those companies.

- JR Hokkaido: 60 billion yen (1/2 subsidies, 1/2 interest-free loans)
- JR Shikoku: 40 billion yen (1/2 subsidies, 1/2 interest-free loans)
- JR Kyushu: 50 billion yen (interest-free loans)
- JR Freight: 70 billion yen (interest-free loans)
19 billion yen (for Seikan Tunnel locomotives, etc., 1/2 subsidies, 1/2 interest-free loans)

JR Kyushu

JR Kyushu reported more than ¥10 billion in ordinary profits in FY2011, and business is improving steadily as a whole. This is due to increases in revenue from related businesses following the full opening of the Kyushu Shinkansen in March 2011 and the start of business at the JR Kyushu Hakata City commercial facility. In railway business, JR Kyushu encompasses many loss-making regional lines, causing an approximately ¥40 billion operating loss for FY2011 that was offset by investment profits from the Management Stabilization Fund.

In this situation, JR Kyushu aims to list its stock during FY2016 and must expand earnings by decreasing losses in the railway part of its business. Before listing, the company will also need to clarify issues with the government and JRJT.

JR Freight

JR Freight plays a key role in the government policy promoting a modal shift to rail freight to protect the global environment. Consequently, it receives support in terms of budgetary measures and tax breaks to update aging facilities. However, with the economic downturn following the Lehman collapse and due to other causes, ordinary profits in FY2011 were just ¥100 million, indicating the difficult business situation.

JR Freight needs to maintain efforts to achieve self-reliance through measures such as making management more efficient and using support from JRJT. The Ministry of Land, Infrastructure, Transport and Tourism is working with JRJT to clarify management issues by holding round-table conferences with experts, shippers, logistics companies, and others on the future vision for rail freight transport. Suggestions will be made to JR Freight following the conclusion of the conferences.

Maintaining Local Services

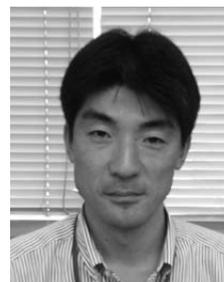
How to secure services on loss-making local lines providing important transport links in provincial areas is a common issue for all six JRs. The situation surrounding unprofitable lines is becoming ever more difficult as users decline, so striking a balance between providing transport supporting people's lives and the impact on the JRs' business is a major issue.

The three fully private JRs on Honshu are exempt from the JR Law so lines can be closed by giving notice under the Railway Business Act. In fact, line closures with agreement from local affected parties were considered (but not implemented) after complete privatization. However, future population decrease will make more lines unprofitable, and coordinating closures with local communities desperate to keep their rail transport is set to be a major issue.

Conclusions

Due to my position in the JRs' affairs at the Ministry of Land, Infrastructure, Transport and Tourism, the second half of this article covering various issues is somewhat lengthy. However, as noted in the first half, the replacement of the bankrupt JNR with efficient and profitable private railways has been a relative success.

The final issue is for the three smaller island JRs, which have not achieved full privatization yet, to improve business while recognizing the needs of communities and customers, so they can become self-reliant as soon as possible. The Ministry of Land, Infrastructure, Transport and Tourism also plans to make the necessary efforts to bring the JNR reform to a conclusion. ■



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Mr Kobayashi is a Director of JR Affairs Office, Railway Industries Division, Railway Bureau in the Ministry of Land, Infrastructure, Transport and Tourism (MLIT). He joined the former Ministry of Transport in 1994 following graduation from the Faculty of Law of the University of Tokyo. He earned his Masters in Public Policy at the University of Southern California in 2007.