2. General Overview

COMPARISON OF PRIVATIZATION AND DEREGULATION IN THE USA, THE UK, AND JAPAN

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This paper summarizes the three country overview papers and eleven industry papers, and seeks suggestions for future regulatory reforms in Japan. The summaries and comments in this paper are made on the ERI staffs’ responsibility and do not necessarily reflect the co-study members views, nor the official view of the EPA or the Japanese Government.
OVERVIEW

This paper summarizes the fourteen papers written by the participants of the joint-study, namely, three country overview papers authored by the chairmen of the U.S, the U.K. and Japan subcommittees, and eleven papers covering each of the four industries (telecommunications, electricity, airlines, and trucking; in the US excluding trucking) written by the participants of the joint-study project. This paper also seeks suggestions out of US and UK experiences for future regulatory reforms in Japan.

The first section compares the general characteristics of privatization and deregulation in the three countries, mainly relying on the three chairmen’s overview papers. The next four sections compare each of the four industries, based on the industry papers. Section 6 summarizes some major differences between the US and the UK experiences and Japan’s situations, focusing on regulatory reform processes, and seeks suggestions for future policy direction in Japan.

1. GENERAL COMPARISON OF THE THREE COUNTRIES
1.1. Deregulation in the USA

Dr. Lewis Perl shows a very instructive viewpoint on the US deregulation experiences of the three industries. He lists the cases in which competitive forces strengthened:

i) that an industry which had been a natural-monopoly changed into a potentially competitive one due to expansion of its market size or technological change, such as in telecommunications and electric power generation;

ii) that services of an industry were priced artificially different from their costs due to cross-subsidies, which invited new entry to seek cream-skimming in the market, such as in long-distance telecommunications; and

iii) that an industry under regulation was basically competitive and its market structure was simple enough to be politically understandable, such as in airlines and trucking.

On the contrary, the pace of deregulation and competition in local call and access services in telecommunications and electricity “retail” markets have been slow and some of them are still in dispute. This mainly comes from the complexity of their markets. New technologies turned those regulated industries into a partially competitive one, but the remaining part of the market had to be regulated like a natural monopoly case to protect small consumers who didn’t have choice. As a result, the entire market became a mixture of competitiveness and regulation, and regulatory reforms tended to take long time because of political complexity and technical difficulty of regulatory designing.

In addition, characteristic of the US, federal regulations were apt to be reformed rather straightforwardly, in such services as long-distance calls, airlines and interstate trucking, whereas state regulations tended to take longer time with a lot of controversy.
1.2. Privatization and deregulation in the U.K.

According to Prof. Yarrow, the U.K. privatization and deregulation proceeded in three stages since Thatcher Administration started.

i) At the first stage of the privatization from 1979 through 1983, privatization centered on smaller size companies or relatively competitive, private company type enterprises such as British Petroleum and Cable & Wireless.

ii) Since the privatization of British Telecom (BT) in 1984, the U.K. Government privatized major government-owned corporations whose markets had been believed to be a natural monopoly. New regulatory agencies such as OFTEL were established. However, the privatization in this period did not always bring about active competition. When BT was privatized, the Government allowed only one competitor in the long-distance telephone market, and British Gas monopoly remained intact after its privatization. The Government intended to promote competition in the airline industry but the dominant market power of British Airways (BA) persisted even after the privatization in 1987.

iii) Since the end of the 1980s the Government has emphasized more to promote privatization and market competition together, and conducted major regulatory reforms as well as privatization. In the electricity privatization, taking into account the problem of British Gas monopoly, the Government divided the vertically integrated national monopoly into generation, transmission, and distribution and access. In the generation sector which was believed to be competitive, it established two generating companies to compete each other. In telecommunications, the Government widely licensed new entry into long-distance calls and allowed the cable television (CATV) companies to offer local telecom services.

1.3. Regulatory problems of Japan

According to Prof. Nambu, Japan's major deregulation processes, some accompanied by privatization of public corporations, appeared like the U.K. cases, but the combination between privatization and deregulation was very different from that of the U.K. Also different was the relationship between regulators and regulated industries. He emphasizes that in Japan economic welfare has suffered from problems brought about by regulations.

He is critical of Japan's regulation and deregulation policies from the following viewpoints:

i) Regulations, and in particular supply-demand balancing requirements, has contributed a lot to international price differential of services. In electricity, telecoms and airlines, new entry has been strictly restricted and high price structure is built-in in those industries. Productivity levels in airlines and electricity in Japan fall short of those in other industrialized countries. The resultant high price among those services gives negative impact on international competitiveness of Japan's tradable goods sectors.

ii) As for government-business relations, among many regulated industries including electricity and airlines, both regulators and management of regulated industries has shared conservative
attitude and tended to resist any regulatory reform initiatives. On the other hand, in some industries including telecommunications, regulators and corporate management have conflict with each other, delaying many crucial decisions.

2. PRIVATIZATION AND DEREGULATION OF TELECOMMUNICATIONS

A. LONG-DISTANCE MARKET

In any countries, regulatory relaxation of telecommunications started first in the long-distance area. It has been increasingly perceived that market size expansion and technological innovations have transformed the long-distance market from natural monopoly into a potentially competitive one. In all of the three countries this co-study covers, liberalization of long-distance market was initiated in the mid-1980s.

A.1. Deregulation in the USA

In the USA, according to Dr. Perl, the fact that prices of long-distance service had been well over its costs was a major cause of pressure for competitive entry. Before major deregulation policies were taken, new entrants such as MCI often entered the market first and then were ready to fight regulators or incumbents at the regulatory process or at the court, rather than wait for their entry application to be accepted.

The division of AT&T was argued not as telecommunications policy but as anti-monopoly policy, and was finally determined in 1982. In the US explicit rate rebalancing between long-distance and local services was not achieved, but after the divestiture, access charges were introduced for long-distance service providers to share adequate part of cost of local and access services.

A.2. Privatization and deregulation in the U.K.

In the U.K, British Telecom (BT) was privatized in 1984. Different from AT&T, it maintained its vertically integrated network. In the 1980s the U.K. regulators employed the “duopoly policy”, allowing only one competitor Mercury in the market, thus the BT dominance continued. In the 1990s the U.K. Government introduced more competition by allowing many other firms to enter the market.

The UK Government charged a price cap regulation to BT, and BT attained rate rebalancing under the price cap formula.

Development of international telecommunications is extremely important for the U.K. In the U.K., competition in this area has been limited by the maintenance of a duopoly in the provision of international infrastructure. However, service providers such as international resellers have eroded the position for BT and Mercury to some extent.
A.3. Privatization and deregulation in Japan

In Japan, at the time of the privatization of the Nippon Telegraph and Telephone (NTT), competition was introduced and three new common carriers (NCCs) were allowed to enter the long-distance market. Cross-subsidies from long-distance to local service inside the NTT Public Corporation was not corrected, and as a result long-distance service prices were higher than its costs, so the NCCs enjoyed high profit, taking advantage of artificially high rates. This should attract other firms to try to enter. But new entry is subject to permission by the Ministry of Posts and Telecommunications (MPT), which can determine the number of businesses in the market, based on the demand-supply balancing clause of the Telecommunications Business Act of 1985. According to Prof. Nambu, the MPT has not allowed any subsequent entry. Thus he points out that competition has not worked. The NCCs (at least two of them) have recorded favorable management performances, but this does not necessary mean they are efficient and competitive, because they have not been tested in the genuinely competitive market. Prof. Nambu wonders if this MPT policy is a kind of infant industry protection for the NCCs, but questions that, if so, time limit must be attached to such a policy.

After long negotiation, in 1994 the NCCs finally agreed to pay access charges to the NTT. This may have considerably impact on the NCCs' profitability.

B. LOCAL AND ACCESS SERVICES

Local exchange and access services were formerly believed to be a typical natural monopoly, but again thanks to new technologies it is changing into a fairly competitive industry. Still, it is controversial if full scale introduction of competition is appropriate. Even after liberalization of the market, at least a part of the customers might have to rely on remaining public utility type service providers.

B.1. Present situation in the USA

In the USA, local and access markets are rapidly changing with many actual and potential new players. Prof. Harris points out that access service revenues and profitability are highly concentrated to small number of customers, while LECs have an obligation to serve all customers, so competitive entrants can focus on customers with highest expected returns. Long-distance providers are tying to enter local or short-distance (intra-LATA) services; competitive access providers (CAPs) offer direct access between big customers and long-distance networks, bypassing local exchange carrier loops; private lines and cellular phones are increasingly participating as competitors; and cable television companies will almost surely enter the local services soon.

B.2. Present situation in the U.K.

In the U.K., after the duopoly policy was abandoned in 1991, the regulators have licensed various businesses for local and access services. Among them, many CATV providers came into the market. They are even trying to enter long-distance services by interconnecting each others'
local networks. The U.K. Government has promoted the development of radio-based telecommunications, both mobile systems such as PCS and fixed radio access, though the latter has not yet come into operation. These technologies may have an influence upon the industrial structure.

B.3. Present condition in Japan

In Japan, at the time of the NTT privatization and telecommunications regulatory reform in 1985, the Telecommunications Business Act allowed competition even in the local markets, leading the world. Actually subsidiaries of regional electric utility companies entered into local services in the respective franchise region. However, according to Prof. Nambu, the following regulatory arrangements among others have impeded effective competition in the market, and even now the NTT’s de facto monopoly is continuing:

i) Under the 1985 Law, telecommunications businesses type I (carriers owning their exchangers and line facilities) are subject to permission for entry and approval for rate making, irrespective of their firm size or kind of services.

ii) As cross-subsidies in the NTT continues, its local and access rates are lower than their costs, thus leaving new entrants uncompetitive in terms of prices.

iii) The actual entrants (electric utility subsidiaries) have been regulated such that their subscribers cannot access to NTT network subscribers, and that the companies are not allowed to interconnect to provide long-distance services.

The first condition is going to be partly unproved because the Government’s “Deregulation Promotion Action Plan” starting in 1995 includes regulatory change in telecommunications area that price approval in type I carriers be relaxed to notification except basic services related to people’s life. It is still unclear in what kind of services price regulation will be relaxed.

C. RATE-MAKING REGULATIONS

C.1. US and U.K. regulatory schemes

In the U.K., at the initial stage of the BT privatization, a price cap formula was introduced, and under this scheme rate rebalancing was carried out. In the USA, according to Dr. Perl, because of the introduction of competition, investment risks increased among incumbent businesses, and under the fully distribute cost (FDC) regulation the investment risk was passed on to customers as sunk costs. So many State public utility commissions are considering of changing price regulation systems from cost-based regulation to price cap formula.

C.2. Japan’s regulatory reform

In Japan, for the type I carriers, rate regulation remains FDC- and fair return-based. According to Prof. Nambu, the FDC formula has following problems:
i) it does not contain incentive mechanisms for efficiency improvement; 
ii) it may give incentives for excessive investment; 
iii) in case of new services, insufficient information on their true costs is available; and 
iv) a new type I entrant cannot employ a so-called strategic pricing (to set a rate below its cost at the initial stage of entry to attract customers, aiming at expansion of its network size to exceed the critical mass for business survival).

The third problem could be common in telecommunications as various new businesses emerge. The fourth problems may have affected cellular phone and cable television services. Their service prices have remained high and failed to attract customers, and they were suffering low penetration ratio. In case of cellular phone, though, owing to foreign pressure, regulation was relaxed in 1994 to allow sales of telephone sets (formerly only rental was allowed), and competition became very active, resulting in lower rates and doubling of subscribers. In the case of CATV, still very low penetration ratio of 5% or so causes concern for the future multimedia development. In Japan CATV has been subject to regulations as broadcasting, not as miscellaneous entertainment media, on contents of programs, on franchise region and so-called localism rule of capital, and on rate-making. In 1993 some regulatory relaxation were carried out, including expansion of service areas and relaxation of capital requirement (formerly confined to local capital in the franchise area).

3. PRIVATIZATION AND DEREGULATION OF ELECTRICITY
A. BACKGROUND OF REGULATORY REFORM

According to Dr. Perl, a leading force of regulatory reform in electricity was again artificial discrepancy between prices and costs. Other driving forces were technological progress in the generation sector, and expansion of market size, that is, widening of transmission networks enabled by broad interconnection of franchise networks. As a result, in the generation market, the room expanded for potential competition among utilities and competitive entry by independent power generators and co-generators. Nevertheless, because of the complexity that even after regulatory relaxation some part of the market must remain regulated, the deregulation is necessarily a time-consuming process.

A.1. Pressure toward regulatory reform in the USA

According to Dr. Perl, the cost and price discrepancy resulted from excessive investment in coal and nuclear generation plants during the high oil price period. The resultant high capital cost and fall of oil and gas prices caused the difference between the average cost of incumbent utilities with high fixed cost and that of new entrants with lower capital cost taking advantage of new technology with high energy efficiency.
A.2. Pressure toward regulatory reform in the U.K.

The U.K. electricity regulatory reforms were conducted basically on the course of general trend of privatization, but major competitive forces seem to be common to the US case. In addition, the obligation of the national electric utility company to purchase almost all of coal produced domestically influenced its cost.

A.3. Pressure toward regulatory reform in Japan

In Japan, according to Prof. Nambu, due to regional monopoly, cost-based price regulation and obligation for stable supply, incentives for efficiency improvement did not work well, and, helped by yen rate hike, international price differential expanded. According to Prof. Kibune, electricity price declined by 13% from 1980 through 1993, but it is more than 30% higher than in other major countries. Other problems are supply side ones, including i) deterioration of load factor and ii) worsening of public acceptance and resultant location of new plants in remote areas from dense demand areas. On the former condition, one percent improvement of load factor is expected to lower cost by roughly one percent. This suggests that even in Japan excessive capacity possibly exists, created by fair rate-of-return regulation and deterioration of supply-side conditions. Seeing that capital cost accounts for 42% of the total cost, one cannot deny the case of substantial cost difference between electric utilities and independent generators.

B. DIRECTION OF REGULATORY REFORMS

B.1. U.K. privatization and deregulation

The front runner of electricity regulatory reform is the U.K. There, partly because the 1987 gas privatization left strong market power of British Gas, promotion of competition was emphasized. So when the national electricity monopoly was privatized in 1990, the vertically integrated corporation was divided into generation, transmission and distribution. The transmission part, National Grid, was left as a monopoly, and regional distribution companies were left as franchise monopoly, but in generation sector two companies were created to compete each other. Big customers were allowed to purchase electricity from any generator they choose. In 1998 this choice will be widened to all customers. The competitive retail electricity market will be formed and consumers should obtain the full right to “exit” from any provider. However, Prof. Robinson points out that the electricity market liberalization is still insufficient, and that the two generation companies (plus one nuclear power company) maintains strong market power.

B.2. Current situation in the USA

In the US, the pace of electricity regulatory reform has been relatively slow partly because the regulators are mostly State governments. Entry into the wholesale market goes back to 1979 when the Public Utilities Regulatory Policy Act (PURPA), which was energy and environment policy rather than competition or industrial policy, was implemented. It first obliged electric utilities to purchase electricity from qualified facilities by the avoided cost, then a competitive
bidding system for long-term power sales contracts eventually became prevailed.

According to Dr. Kahn, though, partly because of problems of the bidding system and resultant political intervention into the process, contracted rates between utilities and independent generators tended to be high. This phenomenon was particularly significant in the phase of lowering fuel costs, because once a certain price was contracted, then even before the plant construction started, it was politically difficult for utilities to request revision of contracted terms even if their fuel cost declined. It tended to cause downward rigidity of electricity prices.

The reform of the scheme is now under way, and the reform process may lead to more comprehensive regulatory reform. Independent generators are requesting direct sales to large-size industrial customers, and industrial customers are seeking direct contract with lowest-price generators. Should these to be realized, liberalization of retail market would be achieved, and price regulation might be unnecessary. If such regulations were eliminated, spot price of generation capacity would emerge and market price would be realized. In California, the public utility commission temporarily adopted such a drastic reform proposal.

B.3. Japan’s deregulation initiatives

In Japan, at the beginning of 1996, the following regulatory reforms will be introduced:

i) to liberalize the wholesale market, that is, to change the current licensing system into competitive bidding;

ii) to allow independent generators to sell their electricity, through transmission channels (wheeling) to other utility companies than their franchise utilities;

iii) to introduce the specific electric utility project, in which a licensed independent generators can sell electricity directly to final users in a limited area;

iv) to employ a yardstick rule for rate-making;

v) to relax rate-making regulation from the current approval to notification system, in case of modifying price structure for the purpose of leveling the loads; and

vi) to streamline safety regulations.

The followings are the expected gains and problems of the reform:

i) New entry into the generation sector is expected to enhance efficiency. Even if its volume is relatively low (c.f. the current generation share of independent generators is 11%), its contracted price can indicate utility companies’ marginal costs.

ii) For further efficient use of transmission channels expansion of access to the networks is indispensable, but pricing of transmission network use is unsettled.

iii) Introduction of yardstick rule in rate-making regulation is a favorable step, but the basic framework of the FDC scheme will be maintained, and pricing bringing incentives for efficiency enhancement such as price cap rule will not be employed.
4. PRIVATIZATION AND DEREGULATION OF AIRLINES

A. DEREGULATION PROCESS

Airlines industry is competitive by nature, but here again Prof. Perl points out that discrepancy between price and cost caused by cross-subsidies from dense traffic routes to local routes may have lead to a pressure for regulatory reform.

A.1. Deregulation in the USA

In the US, before the deregulation 16 carriers had been granted certificates to operate at major routes, and new entrants had not been licensed for trunk routes. Rate-making had been regulated based on the fully distributed cost (FDC) scheme with cross-subsidies between routes. Instead of price competition, carriers competed in services such as flight frequency and number of seats available.

Criticism of regulation by economists began as early as in the 1950s. Finally in 1978 the Airline Deregulation Act passed the Congress, eliminating entry and exit regulations and price regulations. One characteristic of the deregulation process was that the Civil Aeronautic Board (CAB), the regulatory body, itself conducted the deregulation. After all the market regulations were phased out, the CAB was abolished in 1985.

A.2. Privatization and deregulation in the U.K.

In U.K., in the late 1970s British Airways' management performance deteriorated sharply. Thatcher Administration initiated an examination of BA privatization. In 1981, considering future privatization, a major management restructuring of BA started, and significantly improved its performance by reducing its employment by one-third. In 1987 BA was privatized by selling all the BA shares held by the Government to the public. Besides the privatization, substantial regulatory relaxation was also conducted, abolishing route licenses and domestic fare regulations.

Since pre-privatization period the basic stance of the U.K. Government was the “multi-airline policy” to stimulate competition. However, the Government also often tried to restrict competition to protect BA to maintain and strengthen its competitiveness. As a result, the scope of competition was fairly limited, and the second largest carrier British Caledonian Airways (BCal) failed in 1986 and was acquired by BA.

A.3. Japan’s regulatory reform

In Japan, due to entry regulation by licensing and price approval based on the same-fare-for-same-distance rule, competition was suppressed, and fare reduction and service improvement were limited. In 1986 a regulatory reform was carried out. It included the system of multi-airline operation in busy routes (“double- and triple-tracking”). This policy did widen the choice of passengers, but fundamentally it was a regulatory revision in the context of existing regulatory framework, and thus it was just the reallocation of vested rights held by incumbent airlines. As for fare, in the early 1990s, though the normal ticket fares in Japan and the US for routes of similar
distance were roughly identical, discount fares in the US were one-half to one-fourth of those in Japan. In 1994 the Civil Aeronautics Law was amended to relax the regulation on fare discount up to 50% from approval to notification.

B. MARKET PERFORMANCE SINCE REGULATORY REFORMS

B.1. Performance in the USA

In the US, the number of airlines doubled after the deregulation, then turned to decrease. This caused concern that deregulation might lead to market concentration. However, airlines actually compete in each route. The average number of carriers in one route has been in increasing trend, suggesting competition has become more active. Fares have lowered significantly. According to Prof. Morrison’s counter-factual analysis, in 1993 the actual fare was 22% lower than if regulations had been maintained. Hub-and-spoke system brought about higher flight frequency, which, by some economists, account for a major part of consumer welfare gain of airline deregulation. Airline employment in total increased by 80% from 1976 to 1993, though thousands of workers lost their jobs each time of bankruptcy and disappearance of major carriers.

B.2. Performance in the U.K.

In the U.K. deregulation failed to attain enough competition in the airline market, and BA’s market dominance persists. Besides, management restructuring of BA that originated in 1981 has proved very successful. Its fares have declined steadily since the mid-1980s, and its productivity has risen. The BA’s profitability improved and recorded positive profit even in the early 1990s when many other major airlines in the world turned to red ink. Though competition was not enhanced domestically, competition among European carriers have become active.

B.3. New sources of concern for emergence of market power

In the USA, potential problems are argued that could lead to market dominance of large airlines, namely, hub-and-spoke system, frequent flyer programs, computer reservation systems, and travel agent commission. These systems could potentially influence behavior of passengers and travel agents, thus could artificially create the economies of scale. Prof. Morrison points out, among others, that the frequent flyer programs could cause a client-agent problem for business travelers, that is, a business passengers could seek a larger FF premium irrespective of flight fare because the fare is paid by his/her employer.

For the time being, though, there is little evidence that these systems are raising market concentration or strengthening large carriers’ ability to raise their fares. Some insist on introduction of regulations on these problems, but considering rapid change in marketing technology, such as the case of a US airline offering direct telephone reservation at the company, bypassing travel agents, it would be inadequate to hastily introduce rigid regulations.
B.4. Japan’s performance

In Japan, after the regulatory change in 1986, profitability of airline companies became unstable, due to cost increase and real revenue loss. Its impact was apparently different from one airline to another.

Prof. Yamauchi and Prof. Murakami estimate that, if the current artificial fare structure based on cross-subsidies were abandoned and cost-based fares were employed, passengers of long-haul and trunk routes would gain, and those of short-haul and local routes would lose. In total, consumer surplus would increase by seven billion yen.

As fare competition has been suppressed, passengers tended to choose airlines that offer more service frequency and more available seats, and airlines have competed in such services. Service competition under price regulation is generally apt to cause excess capacity and resultant misallocation of resources. In case of Japan’s regulatory change, an econometric analysis by the two Professors concludes that in some routes excess capacity may possibly have emerged, but that flights in “triple-tracking” routes and in “double-tracking” routes whose one terminus is Haneda (Tokyo) or Itami (Osaka) showed congestion rather than excess capacity, suggesting the necessity of capacity expansion of the busy airports.

B.5. Airport capacity restriction

Japan’s airport restriction is always emphasized, but the U.K. case is more or less similar to Japan’s. According to Prof. Yarrow, London airports, in particular London Heathrow Airport, are much congested. Access to Heathrow used to be allocated to airlines with the actual prior to 1977 record of access, as an exception of liberalized route entry. Even after the abolition of this constraint in 1991, it is suspected that slot allocation is carried out preferring vested rights. Some European and American airlines abandoned their intention to access London airports and successfully opened services to other major British cities such as Manchester and Liverpool.

5. DEREGULATION OF TRUCKING

5.1. Deregulation in the USA

In the USA, the Federal Government (ICC) regulates interstate trucking and State governments cover intrastate ones.\footnote{After regulatory relaxation of interstate trucking in the early 1980s some former economic experts of trucking regulation got out of the research of this industry, because the deregulation was no more a challenging policy issue and because data availability has become limited compared to the era of Interstate Commerce Commission (ICC) regulation. Professor Nancy Rose of the MIT and Professor *** of the UC Berkeley told this to one of the authors. So we could not find a co-study member covering the US trucking deregulation. The description here relies on Nambu, T. and M. Eto “Oubei no Kiseikanwa to Min’ei ka” (Deregulation and Privatization in Europe and in America),} As for interstate trucking, until the 1970s strict entry regulation
was carried out, particularly on common carriers that provide services to general customers. An applicant to new entry was obliged to prove contribution to public interest and necessity of its service as well as its ability and adequacy, and was very difficult to be licensed. Fares were to be registered with the ICC and the ICC could reject them if necessary. For the purpose of fare registration and public notice, trucking companies formed rate bureaus region by region and collectively determined their fares.

Relaxation of entry regulation had gradually progressed through court judgments and ICC procedures. Then in 1980 the Motor Carrier Act substantially relaxed entry licensing regulations, getting rid of requirements to prove necessity or public interests. The fare regulation scheme was not modified, but the rate bureau systems became increasingly nominal, and big discount became common.

The number of interstate carriers doubled during the 1980s, and most of the new entry were small size carriers. Among large size carriers, market concentration ratio has risen and tendency toward oligopoly is being concerned, but actually carriers actively entered other regions, thus competition in each route has advanced. There is no evidence of decrease in services or fare hike for small communities.

As for intrastate trucking regulated by State governments, the extent of regulation is diverse from roughly no regulation in some States to tight control in another. Some States have conducted major relaxation but as a whole trend toward deregulation is not significant.

5.2. Deregulation in the U.K.

In the U.K., until the 1960s, new entry was strictly limited under a business license system. This scheme had been criticized that the regulation made the industry inefficient and that it was useless for promotion of railroad transportation, traffic safety, environmental protection and improvement of traffic congestion. The 1968 Transport Act changed the licensing system from quantity-based to quality-based “operator’s license” system, and thus lowered entry barriers. Significant reduction of accident rate and lowering of fares through enhanced competition were achieved since then.

A significant characteristic of the U.K. trucking market is that the competition is not confined to domestic market but in European wide. Dr. Helen Lawton Smith says the European Commission had an indirect impact on domestic regulation as a result of successfully promoting changes in the regulations governing international haulage and cabotage.

5.3. Deregulation in Japan

In Japan, before the regulatory reform, the trucking industry was regulated under the Road Transportation Law, with licensing based on supply-demand balancing clause and fare approval. The law controlled both freight and passenger carriers, but the implementation of regulation on
trucking was much less tight than on passenger carriers. The Ministry of Transportation approved tariff band, and furthermore, market rates determined on the negotiation basis were said to be dominant. Nevertheless, the existence of the supply-demand balancing clause was problematic. The regulators were often obliged to make decision for issuance of business licenses under insufficient regional information on supply and demand.

One significant event in Japan’s history of public regulations was the success of door-to-door delivery services, which started in 1976. At the initial stage the MOT did not welcome the new service and delayed approval. Still, entrepreneurship overcame and the service grew by 22.7% at annual rate between 1981 and 1993.

The Motor-truck Transport Business Act of 1990 brought about a major regulatory reform of the trucking. This reform was characteristic of the fact that it was carried out as new legislation and that it was conducted without any gaiatsu, or foreign pressure, unlike many other regulatory reforms in Japan. The law replaced business licensing with permission, and fares and charges became subject to notification. Separation of route trucking and area trucking was relaxed somewhat. However, this reform can be seen in some respect just the ratification of the existing state of affairs, because, as already mentioned, even before the regulatory change economic regulations had not been so tight. Finally, the “contingency demand-supply adjustment” clause, a kind of safeguard against regional excess supply, remained.

The regulatory reform was substantial but not complete, and as only a few years have passed since then, its economic effect is still unclear. After the reform the number of area trucking carriers increased while that of special consolidated carriers (trucking service to collect loads from general customers, to consolidate them at a terminal and carry; formerly called route carriers) decreased. The latter might reflect the regulatory relaxation that enabled re-entry easier. The average size of special consolidated carriers expanded, which may show that the regulatory reform encouraged structural transformation of the industry.

According to Prof. Yamauchi’s estimation, assuming 10% decline in trucking fare, consumers (shippers’) surplus would increase by 1.2 trillion yen.

6. GENERAL CHARACTERISTICS OF PRIVATIZATION AND DREGULATION PROCESSES IN THE THREE COUNTRIES AND IMPLICATION FOR JAPAN

In the previous sections we have summarized industry-by-industry comparisons of privatization and deregulation in the USA, the U.K. and Japan. In this section, we will pick up some general characteristics of privatization and deregulation processes common to the US and the U.K., and seek implications in deregulation policy formation in Japan in the future.

A. PRAGMATIC APPROACH

The US and the U.K. experiences on privatization and deregulation policies show that, while their policies have been based on such “principles” as promotion of competition and full use
of market forces, at the stages of policy application they have allowed many trials and errors. Many Japanese tend to perceive that in the US and the U.K. liberalization policies have been conducted in a straightforward manner and that the processes are mostly completed. The fact is, respective deregulation policies have often faced difficulty, and pragmatic approaches were taken to settle or get around the problems in case-by-case basis. Even now, many problems remain and trials and errors are going on.

In the U.K., Prof. Yarrow showed that after the start of Thatcher Administration, the privatization process have progressed through the three stages. In the case of airlines and long-distance telecommunications in the 1980s after their privatization, the Government tried to promote competition in a duopoly regime. That strategy was proved unsuccessful as seen in the failure of British Caledonian Airways, so in the 1990s the policy changed into encouraging more entry. At the time of the electricity privatization, considering the gas case that a powerful monopoly emerged, the vertically integrated national company was divided to weaken market power.

In the US, Dr. Perl pointed out that, in industries regulated by State governments, or in markets in which competition and regulation must coexist, deregulation processes have been slow and controversial. In telecommunications, arguments are under way on mutual entry of long-distance and short-distance or local networks or on mutual entry of telecoms and entertainment services. In electricity, the opening of electricity wholesale market was initiated in the 1970s, but its bidding process proved to have a defect which could cause some bias of pricing by inviting political intervention. Modification of the process is being argued. Even in airlines in which the Federal Government smoothly conducted elimination of regulatory in the late 1970s, rapid marketing innovations causes concern for the emergence of new market power.

In Japan, the ultimate goals of regulation and deregulation policies are often unclear. Furthermore, regulators are inclined to avoid trials and errors in the application of the policies. So, the likely results are just the status quo. The problem is, such network-type industries as were covered in this co-study can develop very rapidly and toward an unexpected direction as information technology develops. Thus in regulatory policies, trials and errors are unavoidable. To try to avoid them can hinder the industrial development itself, and can sacrifice future jobs and living standard.

B. RELATIONS BETWEEN REGULATORS AND BUSINESS

The market pressure toward deregulation and competition that Dr. Perl pointed out about the US case also apply to the U.K. and Japan. The international price differential, characteristic of Japan, is a major force for deregulation in the country, but in the US, requests for price reduction in electricity and telecommunications promoted deregulation. That is, economic backgrounds of pressure toward deregulation should be common to the three countries. Difference between Japan and the other countries lies in the relations between regulators and business.
B.1. Regulators' behavior

Japan's regulators are often criticized as resisting regulatory reforms. Prof. Nambu writes “bureaucrats are never entrepreneur and they are usually lacking imagination towards the future.” This might be a nature common to any bureaucracy, but one can point out the following characteristics on Japan's regulators as compared to the US and the U.K.

First, reviewing the regulatory history surveyed above, they seem to have stronger inclination to maintain their own organization. In the US, the Civil Aeronautic Board (CAB) conducted the airline deregulation and finally abolished itself. In the U.K., at the time of BT privatization a new regulatory body OFTEL was settled, which should have reduced the power of incumbent regulatory agencies at least relatively. In Japan, even in case of major privatization and regulatory reforms, the structure of regulatory agencies were basically intact.

Second, for each regulated industry, a single government agency covers all the regulations. In the US and U.K., two or more regulators often associate with a regulated industry, sharing regulatory power and even competing each other. In the US, in many cases, in addition to Federal government offices and independent regulatory commissions, anti-monopoly authorities, judiciary authorities and State governments can participate in a regulatory process. In the cases of trucking and airline deregulation, the Congress led the process. In Japan, checks and balances hardly works, nor competition for better performance of regulation.

Third, the entire regulatory system may lack transparency, bringing about large uncertainty for regulated companies and businesses seeking new entry. It has been pointed out that regulators often issue indications and guidance not in statutory form or not open to public. If principles of policy stances were not announced, the public would not clearly know regulators' true intention and policy direction. Furthermore, disclosure of information and data related to regulation is poor, insufficient for evaluation of regulatory performance.

B.2. Behavior of incumbent businesses and new entrants

Regulated business behavior is also different in Japan from the US and the U.K. In the US, Dr. Perl writes on telecoms, “initially the FCC and the state commissions strongly resisted competitive entry. Reform occurred because competitors (like MCI), seeing profit opportunities, aggressively sought to enter the industry. In many cases, these competitors did not seek regulatory approval for entry, but entered and waited to be challenged. Where necessary, entrants challenged

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2 Prof. Robinson writes that the establishment of independent agencies such as OFFER led to more open system.

3 It is often complained that in Japan one has to visit various government offices to submit application forms to ask for any procedures. This may hold good for many social regulations such as construction approval or environment-related approval. In the cases of economic regulations on such network industries as what this co-study cover, a single agency seems to have dominant power.
both regulators and the incumbents in court to secure continued entry on what they regarded as fair terms.” In case of US trucking, accumulation of court judgments were a major factor to nominalize entry regulation. In the U.K., initially CATV providers tried hard to enter the telecommunications market, and finally in 1991 the government licensed many CATVs for telecommunications.

In the US, in addition to cultural and social factors, one background of the phenomenon might be that checks and balances and competition work among regulators, as described above.

In Japan, Prof. Nambu writes that top management of regulated firms tend to flatter and obey regulators, and that consensus between them is often conservative and will not welcome innovation. He writes on the other hand that, if regulators combat with regulated industries, there will be a delay or stalemate of important decision making, missing the best opportunity, such as in the case of telecommunications. This phenomenon may partly come from the fact that businesses do not often appeal to court or choose other measures to against regulators.

Door-to-door delivery service was a significant exceptional case in Japan. A regulated trucking firm finally managed to establish the new service in spite of negative attitude of the regulator. As technological innovation emerges and as economic conditions change, the second and the third such new services can show up.

C. ROLES OF ECONOMISTS

Finally we would mention the roles of economists for promotion of deregulation by means of economic analyses of regulation. In the US, though we should be prudent not to overrate it, economists seem to have played a certain role in the course of the deregulation process. Prof. Alfred Kahn became chairman of the CAB and conducted the airline deregulation. Results of many microeconomic empirical researches on regulation/deregulation influenced arguments in the Congress. In the U.K., Prof. Littlechild’s proposal of price cap scheme was widely employed in the price regulation of privatized industries.

In Japan, for the time being, regretfully there have been few cases that economist proposals or analysis results had a major influence on regulatory reforms. One reason was the difficulty in empirical analyses, first because data are hard to obtain, and second because, different from the US case, regulation is uniform nationwide, so the US type cross-section analysis of state data is not available. Impact of analysis results on political decision may be also different from the US case.

Hopefully, economists might well penetrate more to the analysis of practical regulatory decision-making processes. It would be meaningful to enhance economists’ voice on regulatory processes to objectively evaluate regulations and to make the process more transparent.

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7. CONCLUSION

We have compared regulation and regulatory reforms of four regulated industries, telecommunications, electricity, airlines and trucking in the USA, the U.K., and Japan, based on the papers written by the participants of the co-study project.

In Japan, people seem to have respected the regulatory roles of government in the market economy, and put priority on maintenance of current job and incumbent regulators and regulated businesses.

However, Japan's economic environment will make it difficult to sustain this kind of manner. Japan is facing structural changes, namely, first, prolonged low growth; second, change in Japan's comparative advantage structure caused by yen rate appreciation and development of newly industrializing economies; and third, higher mobility of labor force. Under such transformation, Japanese businesses must seek to regain competitiveness to cope with new environment, and to cultivate new fields of activity. Facing high price and international price differential, Japanese consumers tended to “exit”, that is, just not to buy unreasonable price items, rather than to “voice” their requests or complaints. Now, businesses, in particular tradable goods industries, voice requests to reform the current regulatory systems that brings about high cost and restriction of activity in the Japanese economy.

On the background of the initiation of regulatory reform in the US and in the U.K. in the 1970s were stagflation and lack of confidence in the future economy. And once the tide of reform started to move, it has not to be stopped. Japanese economy is now in the similar condition, and the opportunity of conducting full-scale regulatory reform is maturing, in reference to the US and U.K. experiences.
3. Comments and Discussion

“Summary of the Symposium” Proceedings

Edited by
Economic Research Institute Staffs

* This is the summary of the International Symposium on “The Comparison of Privatization and Deregulation in the U.S.A., the U.K., and Japan” at the Economic Research Institute, Economic Planning Agency on September 19-20, 1995. The ERI staffs are responsible for the summarization.
Tuesday, 19 September 1995
10:00 - 12:30

Session 1: Privatization and Deregulation in the U.S.A.
Chair: George YARROW
Paper: Lewis PERL

1. DISCUSSANTS' COMMENTS
SAKAKIBARA:
1. I was struck by similarities of American, British and Japanese experiences. Decline in growth of the government revenue due to slower growth or increased inflexibility of government expenditure, gradual price rise, inflation after oil crisis, and political atmosphere, all contributed to deregulation.
2. In the case of the airline deregulation, there had been continuous technological development, expansion of market and excess capacity all the time in the airline industry. Still, there was no threat of major entries to the industry; no strong complaint from customers. There was a price/cost disparity, but the profits from the longer-hauls between big cities were not large enough to attract entrants. All the people including management and labor opposed to deregulation.
   If there was a disparity between the dynamic reality and the static regulations that hampered the development of the industry, the complaint must have come from the airline itself, but there were no complaints. So, why it happened in the 1970s was a mystery. It was more of a historical accident due to political atmosphere.
   When the Department of Transportation was established in 1966, there had been large and independent regulatory agencies, and the DOT didn’t have much to do. So they made researches and they were all for competition. Therefore, the relations between the DOT and the regulatory agencies has been delicate from the beginning, which may have been a cause of American deregulation.
3. One of the purposes of deregulation or regulatory reform was to reduce the administrative cost. Is there anyone who did a careful study of how much cost of administering these industries is reduced and how much saving is done by deregulation and regulatory reforms?
4. Regarding the international implication of deregulation, according to Tae-Oum, the Japan Air Lines’ cost per seat/miles was 50% higher than the United, so the market should be liberalized. But we need to make a little longer and dynamic consideration. As yen rate changes, the cost situation is changing all the time. So, I was very much dissatisfied with this kind of discussions. But we need to discuss international implications of deregulation started in the U.S. or in the U.K. or whatever developing countries.
5. According to Perl's paper, the frequent fliers program and the hub-and-spoke system are not so serious a problem to competition. But they could be interpreted as economies of scale, economies of scope maybe, network externalities or so. So we should further discuss on this subject.

6. Finally I would mention the strength of vested interests. If a price cap scheme is adopted in Japan, there might be conspiracies between regulatory agencies and industries about setting the level of X.

KATO:

1. In the U.S. there is a basic understanding that the benefit of deregulation is for the sake of consumers. In Japan, one of the advocates for deregulation is Keidanren which consists of major companies of Japan. They believe that regulation is taking away new business opportunities, thus it gives a very negative impact on their business. Another force for deregulation is the foreign governments, or Gaiatsu. Japanese consumers and Japanese people at large are not very enthusiastic or interested in deregulation.

2. Perl pointed out that the state level opposition serves as an obstacle to deregulatory efforts. We have a similar situation in Japan. In the U.S., in case the Federal government is promoting deregulation while there is a strong opposition on the part of the State level, what sort of adjustment is taken?

3. Economists are expected to analyze the result of deregulation and to estimate regulatory costs.

   (3-1) One way of estimating the regulatory cost is to examine the efficiency loss caused by regulation. This should be analyzed by comparing the situations before and after deregulation. However, in Japan the situation under regulation is often compared with that in unregulated sectors. Two questions emerge. First, without demand expansion, released labor and capital as a result of efficiency gain must be fully utilized in other industrial sectors. People opposing to deregulation is much concerned about unemployment. Second, to what extent the released production factors show efficiency increases in other sectors depends on the industrial structure at work. Economists who say “yes” to these two questions can exaggerate the actual conditions. Japanese consumers may intuitively distrust such estimated gains of deregulation.

   (3-2) The second argument is that regulation causes a loss of business opportunity. They estimate to what extent the business could be enhanced as a result of deregulation. However, if there is a justifiable reason for regulation, the argument should be whether the present regulatory regime is not appropriate, and whether a more efficient regulatory regime exist.

   (3-3) The third argument is the price distortion. They say consumers are victimized because of high cost structure, but it is very difficult to clearly estimate the gains in terms of price that consumers could obtain because of deregulation. We have to measure one by one the impact of deregulation on the economy as a whole.
4. One of the reasons why Japan is lagging behind in terms of deregulation is bureaucracy, which strongly opposes regulatory relaxation. In the U.S. the top or senior posts of bureaucracy are mainly political appointees. Is there any relationship between deregulation and political appointment system in the U.S.?

ROBINSON:
1. We may be forgetting what an awful state U.S. regulation had reached by the 1970s. Regulation of the U.S. sort contained the seeds of its own destruction. The kinds of distortions Dr. Perl has explained may be endemic to that kind of system.

   Originally people thought that regulation in the U.S. was for the “public interest”, but in practice it was very poor in protecting any kind of public interest. George Stigler wrote that regulation was acquired by the industry and was designed and operated for its benefit. Regulators tend to restrict entry into an industry, enabling producers to raise prices in their own monopoly realms. Under the U.S. system with a short tenure, regulators have to look to their future employment in distributing those gains.

   Within regulation there turned out to be some very strong pressures to deregulation. One was the pressure from the producer pressure groups, which either suffered from high prices or were potential entrants to regulated industries. Consumers are unorganized, and policy making is dominated by producer interests, but producers have inputs as well as outputs and so they have a consumer role.

   Another pressure was the change in the intellectual climate, which revealed that regulation was being operated in the interest of various pressure groups. That stimulated to deregulation.

   In the U.S., the states have different regulatory systems, which gives an incentive to footloose consumers to choose the states to locate. That seems to have been an important influence, for example, in the deregulation of electricity in California.

2. Regulators in general do not have the information they require. If knowledge derives essentially from market processes, it is logically impossible to reproduce the results of a competitive market by regulation. So regulation should be confined to natural monopolies, though even there it can be dangerous because it may entrench present ways of doing things and obstruct technology development.

   In Britain the regulators have been given specific duties to promote competition in the transition away from monopolized markets towards competitive markets. That reduces the chances of regulatory captures by other interest groups.

3. In principle, price caps have significant advantages over rate of return regulation. Indeed, in Britain, when regulation was being devised, we were very intent on avoiding the rate of return type of regulation. But there is some tendency for the two regimes to converge.

   There is a great difficulty in setting the X-term in the RPI-X formula. Because of the absence of relevant information to regulators, British governments in the early days allowed
our regional electricity companies to make very big profits from the first Xs they set in
electricity distribution. When resetting X the regulators had to look at profits because of
public pressure. Unless price caps actually provide a more stable regime, they may not be so
different from rate of return regulation because one of the main determinants of the size of X
is the profitability of the industry concerned. If one keeps on revising the price cap in
response to public pressure, you do end up with something which is very similar to rate of
return.

4. One point becoming important in the British regulated industries, particularly in
electricity, is the capital market mechanisms. If there is a natural monopoly, by definition the
company is protected from product market competition, but it isn't protected from capital
market competition. Earlier this year the British government abolished the so-called Golden
Shares in the regional electricity companies, which stimulated a number of takeover bids for
these companies. In other words, the market for corporate control began to operate. Not only
did it put pressure on the management concerned, it also provided information for the
regulator.

2. SPEAKER'S REACTIONS

PERL:
1. Morrison's paper on airlines provides the clearest evidence that there are enormous
efficiency gains to be achieved from deregulation. In the other two sectors, the newness of the
change makes it more difficult to come to firm judgments on the basis of the empirical
evidence, but ultimately we will find there have been enormous gains in those sectors as well.

It is easy for academics to argue that the gains from deregulation that occur through
rate rebalancing could have been done without deregulation at all. But without some form of
dramatic regulatory reform or deregulation there won't be rebalancing. It is only fair to
attribute those gains at least in part to regulated reform.

2. Bureaucratic opposition to the reform by the regulators is a universal truth. Airlines
in the U.S. perhaps constitutes the major exception. Whether the bureaucrats are appointed
or elected doesn't makes a great deal of difference.

3. I share Robinson's view of the deregulatory imperative, and the failures of the
existing system being the ultimate cause of the reforms. The unfortunate reality is that at
least in electricity and telecommunications the future does not seem to be deregulation but
regulatory reform. That is, important sectors of both of those industries remain in need of
regulation despite the fact that other sectors of the industries lend themselves to rather
substantial competition. So, I don't think we escape the dilemma of how to institute some
reform that will enable us to capture the benefits of competition in the sectors where it is
feasible, while restricting the industries where it is not.

4. Price cap regulation is a distinct improvement over rate of return, particularly in
areas where it is a mixed mode. I share Robinson’s concern that the two systems are rather
closer together in practice. I think maintaining a sensible price caps regulation is going to be
a more difficult process than most academics anticipated when the reforms began.

3. FLOOR DISCUSSIONS

NAMBU:
1. Prof. Kato’s view that general public is not for deregulation is totally wrong. Those
disadvantaged through deregulation are only a small portion of the general public, but they
have a stronger voice. My intuitive understanding is that people of Japan are supporting
deregulation.
2. The unemployment problems would have to be addressed. But it is not right to say
that, because we cannot find answers to tackle with these problems, we cannot go ahead with
deregulation.
3. In the U.S., deregulation was promoted in a piecemeal manner. You did not have to
get a unanimous support of all ministries and agencies in order to promote deregulation. The
U.S. has a decentralized system. The Department of Justice and FCC may have different
approaches and different stance, and different Administrative agencies may take different
approach. It is easier for the U.S. to move and take certain path, and ex-post-facto checking
will function.

HARRIS: The process of deregulation/privatization in the U.K. was largely a
tops-down process, or a manifestation of Thatcherism. The U.S. deregulation was a
bottoms-up process. It required a decentralized system of regulation in which there were
many loopholes and many limits on the regulatory regime. The force of deregulation was not
from public policy makers, not from politicians, it was from entrepreneurs.

MCI was started by a couple of entrepreneurs who figured out that there was
nothing in the law that prevented them from entering into that business. They did so in
opposition to the regulators of the day. They went to the courts and the courts upheld their
right to enter that business. In airlines there was no entry at the federal level, but there was
a tremendous loophole in airline regulation. The new entrepreneurs entered an unregulated
intra-state market.

I totally agree with Perl about the economic changes, the technological changes and
the distortions in the regulatory system, but it was the entrepreneurs, not the regulators,
that made it happen. Entrepreneurship revealed the inefficiencies of the existing regulatory
system. It is new companies that find ways to exploit these new technical capabilities, and
then ultimately public policy makers must react and change regulations after the fact.

ROBINSON:
In Britain, different from the U.S. Because the utilities were state owned, people were
prohibited by the state from entering the industries. So, the political process had to play more
of a part than did in the U.S.

SAKAKIBARA:
1. In the U.S. the free enterprise system means enterprises are free unless regulated by the law. In Japan, there is so-called administrative guidance, which are not by the law but nobody challenges, because if you did that there might be dreadful retaliation by the government.
2. The cost of building infrastructure is so expensive that it is very hard to liberalize the market. The land is so expensive that a new airport is more economical to be built on the sea than on the land. Furthermore, we do not have the concept of the MM domain. So you have to negotiate with all the related hundreds of people, to build one kilometer of highway. How can you achieve consensus on this?

PERL:
1. One of the most observable aspects of deregulation in both the U.S. and U.K. is the dramatic decline in employment in the traditionally regulated sectors, such as in local exchange companies. And yet, no one has seen any consequence of this on the aggregate employment level in the US economy. Unemployment rates are surely lower in the post deregulatory era than in the prior era. The average length of time unemployed by a worker displaced in a regulated industry is short, about six months. The replacement rate is also high with people's salaries after displacement averaging 80 to 85% of pre-displacement. So, it is not reasonable to oppose deregulation on the grounds of macroeconomic employment effects.
2. Many of the same economic incentives which would bring forth entrepreneurship in Japan to break down regulatory barriers seems to be moving much more slowly. In the U.S. CATV is a very viable competitive force that may make all regulation of telecommunications obsolete. Cable's growth in Japan is very slow. Also in the U.S., if an electric company shows to go into the communications business, it would have the right of interconnection with the existing local exchange companies, as an absolutely established principle. In Japan electric companies which would serve local exchange companies have no right to interconnection, making that an unfeasible form of competition. Is the regulatory enterprise more ubiquitous and therefore more difficult to find loopholes?
3. Very few of the effects of regulation were anticipated at the time of the changes in the reforms. In telecommunications, having instituted competition in the toll part of the market, we now find that it is going to flow into the local market. At the time of airline deregulation the regulators anticipated more competition on trunk routes, but none of them would have thought that the hub and spoke system was going to be the outgrowth. Breaking down some regulatory barriers will inevitably have much more dramatic effects throughout the economy than can ever be anticipated. If before any reforms one must study in great detail all of its ramifications, it will never occur. And if Japan achieves some demonstration effects in some portions of the economy, it becomes an unstoppable force. In the U.S., the
success of airline deregulation made the telecommunications deregulation much easier. Electricity deregulation would go much more easily because of the telecommunications experience.

NAMBU: In Japan now the entrepreneurship is lost. I think we have some kind of Japanese disease. When we look back to the 1960s there existed true entrepreneurship. At that time the MITI was a great regulator, but there existed the challengers in such industries as automobiles, steel and synthetic fiber, which never surrendered to the order of MITI. Only 30 years later, entrepreneurs are so gentleman-like and they wish some kind of agreement with the government before starting something.

KOJIMA: I would emphasize that the deregulation movement was an inevitable process rather than a historical accident.
1. One is the tide toward deregulation. The regulation policy was based on the belief that regulators know better than the market. At some period in history this sounded correct, but the break-even point was reached in the 1960s or 1970s when people realized that the regulators don’t know everything. Sometimes there was a flaw, that is, the regulator became regulated. Eventually that led to the collapse of the extreme form of regulated economy, that is, centrally planned economy. This is one general historical trend.
2. Japanese consumers and corporate managers have noticed the differentials between the domestic and international prices and have chosen the cheapest shop. That is why there is price destruction. As to entrepreneurship, there are some companies like Yamato Transportation, a door-to-door parcel transportation service, whose owner is one of the rare species of true entrepreneurship. He struggled with the Ministry of Transportation and the local vested interests for many years. The problem in Japan is that he belongs to the rare species by now, but I am not too pessimistic to consider that the entrepreneurship is completely extinct from Japan.
3. About the international competition, the cost of Japanese tradable sectors are affected by intermediate input of non-tradable sector products. If we preserve the high cost non-tradable sectors, then eventually the Japanese industry would go down. So the sectors treated here are not limited to these sectors themselves but related to the national economy as a whole. Although we know there is tremendous difficulty in making any slight change in the system, still we have to advocate the regulatory reform.

KATO: I mentioned the likely opposing forces in Japan. The unemployment issue is totally unrelated to the deregulation, but people still have a concern over possible unemployment which might arise as a result of the deregulation.

In Japan there aren’t many people who are really for deregulation. They are not openly opposing the deregulation, but in their real intention they are still the opponents to the deregulation.

HARRIS: It is true that there are vested interests to oppose deregulation, but there
have been countervailing interest who have organized to support deregulation in the U.S. Alliance of manufacturers pushed through a trucking deregulation, for example, over the total opposition of all of the companies in the trucking business. They have been influential. The banks especially have been influential in telecom deregulation. Why wouldn't Keidanren take the leadership on this issue? I believe the reason is they have the most to lose from it. Because once you start the process of deregulation, it has a tendency to spread, and it feeds on itself.

PERL: Harris' observation is very important. Deregulation was never a popular movement among regular consumers. At the time of the break-up of the telecommunications system, most consumers viewed it with great bitterness that this ubiquitous telephone network was being broken up and now you didn't know who repaired the phone and where you got the phone. It is business consumers in the U.S., not the average consumer, that has been the driving force. Perhaps there are countervailing forces in Japan that make industrial consumers less enthusiastic than perhaps they were in the US about deregulation.

(END OF SESSION 1)
Tuesday, 19 September 1995
14:30 - 17:00

Session 2: Privatization and Deregulation in the U.K.
Chair: Tsuruhiko NAMBU
Paper: George YARROW

1. DISCUSSANTS’ COMMENTS

YAMAUCHI:
1. On the RPI-X regulation, how has the X in each industry been determined? In the early stage of privatization, the formula was introduced on the ground that there was not enough information on the company cost. But this recognition has changed now. If X is determined by other factors than productivity gains, such as the rate of return on capital, simplicity of the scheme, one of the most important features of price cap regulation, may be lost, and there will be no difference between the rate of return regulation and RPI-X regulation.

2. i) The U.K. policy makers insist that they have practically introduced competition, even in the case of duopoly. However, there is no clear theoretical linkage between imperfect competition and the economic efficiency. ii) Regarding the ownership transfer itself, Chicago School economists propose the property right economics, in which the behavior of a firm should be influenced by the ownership. But in the U.K. the ownership transfer itself does not seem to bring about clear effects on the operational efficiency. Sales price of state-owned assets in the United Kingdom were much lower than what it should have been. If this is a kind of redistribution policy, what were the implications of such hidden redistribution measures on the efficiency?

3. In the U.K. regulators are expected to regulate the field where monopoly is likely to dominate and to promote competition where it is possible. The “public choice theory” suggests that the regulator does not always behave ideally and the regulation can go toward a wrong direction. According to Bernstein, there is a life cycle in regulatory bodies’ behavior. A regulator in the infant or youth stages acts vigorously, but in the older stage they were captured in the industry favorite.

KAHN:
1. Capital markets provide a regulatory function through the takeover mechanism, but as a practical matter in these very large industries takeovers may well only be feasible from external foreign capital. In the U.K. one U.S. electric utility already made a successful bid for a distribution company. Especially in capital intensive industries like electricity, the number of players in the market for corporate control is really only large when you look at the international factor. Many governments are averse to foreign ownership of infrastructure
industries. To what extent will this be allowed in light of the potential good effects in the market for corporate control versus national concern about foreign ownership?

2. It is not clear whether the limitations on privatization and competition process are political perceptions or underlying realities such as the case of technical risks or public goods aspects. i) In the case of nuclear assets, the stakes for failure are quite high, so my own personal view is that nuclear assets can’t be privatized. On the other hand, whether hydro assets should be privatized is just a matter of perception. ii) In the case of maintaining unprofitable services because uniform rates are politically desired in spite of large geographical variation in cost, bidding for subsidies is an interesting regulatory approach, but there is a political perception of just how far you want to go in the cost de-averaging process. iii) The third case of the limitations is that the regulator is at a serious information disadvantage.

3. Vertical ties among fuel industries and electricity can inhibit competition. Privatization may be viewed as a way to decrease the economic power of a strong vertically tied fuel industry, such as coal and gas industries tied with electricity. But the British Coal case was only feasible because there was a substitute available in the form of natural gas. In Japan the fuel issues are extremely sensitive because Japan imports virtually all of its fuel for electricity. Whether this particular endowment issue is going to limit the potential for competition in Japan is an interesting question.

4. There has been a little discussion about the relationship between electric distribution and telecoms. There is some potential complementary. It is very difficult to set up a regulatory system to deal with these interindustry issues.

MARSHALL:

1. There was little liberalization of the market on privatization. In case of British Gas, at the initial stage there was very little attempt to liberalize the gas industry. The statutory monopoly of supply was removed but none of the economic barriers were removed, so there was no entry. From 1986 until really this year the regulator constantly tried to get effective pro-competitive regulation into the market, and many restrictions were placed on British Gas to try to counterbalance its incumbent power. However, eventually the industry has been substantially restructured, and the distribution network of pipes has been entirely separated from the supply of gas to customers. The industrial and commercial market for gas is now very competitive and essentially free of regulation. A very similar story can be told in relation to electricity generation, where the coal and oil-fired power stations were a duopoly. The decision was taken in 1994 to require the two generators to divest themselves of about six large generating stations in two years, and in the meantime the prices were controlled. Generation, which was not regulated at privatization, was thus deregulated, but that deregulation really stemmed from the initial flawed privatization.

2. In terms of regulating the natural monopolies, RPI-X regulation has been used.
It's quite important to realize that there is no mandate for the regulators to use RPI-X regulation when resetting price controls. The regulators are free to choose whatever form of regulation they think best suited to the circumstances. Now, in electricity, as with all the other price resettings that have occurred, the Xs have been tightened by the regulators, and that indicates that the initial price settings of privatization were relatively lax. When the reviews came up for renewal, Professor Littlechild tightened the price controls very considerably.

3. Regarding the accountability of the regulators, in the electricity and the gas markets there is going to be full competition in gas and electricity supply for domestic customers by 1998, and the regulators are charged with setting in place arrangements to make that widening of competition a success. Prof. Yarrow thinks there are not sufficient checks and balances on the regulators' action in the U.K. system. There is room for improvement, but there is also quite a danger of moving too far in one direction or the other, either to government direct control or towards the U.S. system. The U.K. system is very open. All of the companies who operate in the industries are licensed. They have their obligations and constraints set out in their license. The duties of the regulators are set out in Acts of Parliament and those duties limit the discretion of the regulators, and independence from government is established by the fact that the directors-general of the offices are appointed for fixed terms of five years and usually cannot be removed.

4. We shouldn't overlook the successes associated with privatization and deregulation in the U.K. It is true that there have been considerable job losses in the industries as they became more efficient, but this has actually been managed in the U.K. very well. The efficiency savings are showing through in the returns to shareholders, but also the customers have benefited, and there are many more benefits from the further promotion of competition and tighter regulation.

2. SPEAKER'S REACTIONS

YARROW:
(On Yamauchi's comments)
1. There is no standard procedure for the determination of X. It varies from industry to industry. In water there is considerable attention paid to cash flows in determining X and attention is paid to the investment requirements of the companies for environmental purposes. At the next stage of gas regulation, there is an argument about whether one should move to a cash flow basis or take a simple return on capital. There is no requirement to use RPI-X regulation at all. My own view is it should be kept as simple as possible.
2. About a new theoretical base for regulation in cases of imperfect competition, I am very skeptical about the ability of economists to do that with any sort of generality at all. For example, in the electricity industry at least some of the work on game theory on the U.K.
market gives positively misleading policy conclusions, and it would be better if we didn't have it at all. Market competition is a very messy process and often a very nasty process, but when you look at all the alternatives it's the best of the bad lot.

3. I was talking about the advantages that we've got from the new regulatory structures in the U.K. That is not to say that the regulation can't go wrong. You mentioned public choice theory. That was one of my concerns about checks and balances. When regulators are intervening in a very major way in markets, it is wise to get a second opinion. I think that is not done enough at the moment in the U.K.

(On Kahn's comments)

1. In Britain we love foreign ownership such as Japanese and American inward investment, and there is very little in the way of political problem. It is an important point in terms of the ownership of these natural monopoly assets. The wires and the pipes are in the U.K., and that's an enormous hostage to foreign investors who are spending billions of pounds to actually acquire these investments. All the power in the relationship lies domestically with the domestic regulators, and there is nothing to fear from foreign ownership of those assets. One of the disappointments is that the Japanese investment in the U.K. has not yet reached the utility sectors. When you move further towards deregulation you might find that Japanese utility companies are more active in overseas markets.

2. I agree that it is an extremely difficult problem of what happens when you're getting cross entry from one utility industry to another. I think we are just beginning to think about these problems in the U.K., and I think it is one of the reasons why our current regulatory system is not in a steady state. For example, we are seeing the convergence of broadcasting with telecoms, which is not being picked up very well by the existing regulatory institutions. For the future I think it is one of the areas where economists may be able to contribute towards regulatory thinking.

(On Marshall’s comments)

I would like to stress the question of checks and balances. I am critical of the existing system in the U.K. on a number of counts. There are a number of other people who are also critical of the U.K. system but for entirely different reasons, and one of the dangers is that if there is reform it will be reform in the wrong direction, in particular, toward greater political control and in favor of particular interests. While I remain critical and I would certainly have suggestions to make, one has to be very careful in considering the reform of regulatory institutions.

3. FLOOR DISCUSSIONS

PERL:

The American regulatory scheme with the rate of return structure has functioned rather well for quite a long time. The problem has occurred because the regulators have broadened their
interests to go beyond cost control and getting prices aligned with cost, to social policy that were much more difficult and beyond the skill and competence of the regulator such as environmental policy. As long as the system stuck to the narrow concerns that were originally intended, in the competition between price caps regulation and rate of return regulation, each of them has claims to being reasonable systems.

YARROW:
I am one of those who would prefer it to have a bit more legalism, or judicial control, in the system. We do not yet have a sufficiently robust view of private property rights, In the U.K. there was a mistaken overreaction to what were perceived to be the major deficiencies of rate of return regulation. It is American productivity which is higher, so rate of return regulation wasn’t at all bad in terms of effective performance.

ROBINSON:
Perhaps rate of return versus price cap is not the most important thing. The most important thing is the scope of regulation. I would like to give regulation as little scope as possible because it’s so unsatisfactory.

In Britain the rather illiberal initial privatization schemes have given our regulators tremendous amount of work to do to liberalize. Fortunately, we’ve also given them pro-competition duties, and that’s perhaps one of the more useful characteristics of the British system -- that regulators have this duty which helps to avoid capture by producers or by other interest groups.

KOJIMA:
I have a question about semi-independent regulatory offices. Is it independent from the cabinet? Who appoints the director-general? Assuming in Japan we were to create such an office, it would be just a subsidiary to the existing powerful ministry, or even if it were legally regarded independent there would he personnel secondment. The personnel are simply moved from one organization to another, and industries would lobby the new regulatory body, so still there will be similar vested interest relationship going on. How do you solve those kinds of complications?

PERL:
i) In the U.S., in some state regulation the regulator is an elected official, and in other states and in the federal government, independent regulators are typically appointed by the executive for a fixed term. The elective system has not worked well because the regulator has been far too beholden to populist interests and to an unwillingness to protect the interest of the investor, but the independent regulator with rather well defined rights and responsibilities has generally worked quite well. ii) Traditionally the role of the regulator was to assure that they did not earn excessive rates of return and to exercise a certain rather limited judgment with respect to whether their investment processes were prudent. Still, that discretion was severely limited. Private property rights in the American regulatory system historically were
very strictly enforced and honored. A regulator who sought to set rates so that you could not earn a reasonable return might well be overturned by the courts.

YARROW:
In Britain the model has been the fixed term appointment with duties set out in legislation and, therefore, with potential access to the courts in the event of belief that the regulator has gone wrong. But that access to the courts is too difficult at the moment for technical reasons.

MARSHALL:
i) In the U.K. the regulators can and have appointed their own staff. There have been some secondments from government departments, but not very many, and in the policy making areas the policy makers are outside appointments. ii) The fact that the U.S. regulators have widened their remit into environmental policy, etc. is very interesting because in the U.K., in electricity, and perhaps even more so in gas, we have adamantly tried to restrict our roles to economic regulation and, at the same time, people have tried to thrust on us environmental duties, social obligations, and lots of other things which we have had to resist.

KAHN:
I would like to add a little about legalism in the U.S. system, especially with regard to competition policy. The regulatory agency has a legal mandate. Legalism provides the opportunity for new entrants to exploit ambiguities in the specification of the regulatory charter. It provides opportunity for a forum for competitors that is potentially limiting the capture of the regulation by incumbents.

HARRIS:
MCI used the antitrust laws to say the FCC literally did not have the authority in its statute to prevent MCI from competing in long distance services. However, there is an antitrust doctrine in the U.S. known as the “State Action Doctrine” or “State Action Exemption”. If a state chooses to regulate a sphere of economic activity, then the state and all private parties acting under that regulatory scheme are exempt from the antitrust laws. Even though the federal antitrust laws rule supreme, there is yet an even more supreme principle, the principle of federalism. Airline deregulation occurred because it was an interstate activity and, therefore, we made a federal policy decision. You can't deregulate the electricity industry or the local telephone industry at the national level. It has to be done by fifty individual states, so it takes a long time to happen.

SAKAKIBARA:
i) The major difference between Japan and the two countries so far represented was that they have an independent regulatory body. In Japan the Transport Ministry is both a regulator and the paternalistic defender of the industry, and this system will never work. We should establish an independent regulatory body, or regulator, to regulate the industry. ii) Japan also welcomes foreign investment, but very few people knows it. Our government should make our policy more transparent, in foreign languages, so that everybody can understand.
KIBUNE:
i) Japanese utility companies are not interested in investing overseas, but subsidiaries of Japanese trading companies have invested in the U.S. wholesale electricity market. Next year our wholesale electric market will be opened. In the future, if some affiliates of U.S. utilities try to invest in the Japanese market, it will make our market more open and wider.
ii) In Japan, from the energy security viewpoint, nuclear is one way of the diversification of energy supply. But the government has not shown a consistent principle on nuclear development. In the U.S. power generation is highly market-based, and in the U.K. nuclear power will be privatized. I would like to know your national principles of nuclear development.

ROBINSON:
All fuels have different security characteristics, and for fuel security you want to promote diversity. I would be very doubtful about state promotion of nuclear power for all sorts of reasons, but particularly for reasons of security of supply, such as an extreme example of France, which excessively relies on nuclear energy.

PERL:
If Japan feels that it needs to have a certain level of nuclear dependence in order to maintain its security, a certain portion of the industry can be supplied by the government's nuclear industry. The private industry may not build nuclear capacity, at least not taking the risks that it entails. Still, the rest of the market can be supplied competitively. The real problem is that the need to have an independent security source can be used as a device for opposing all deregulation of the industry.

PERL:
We heard elsewhere that the British government is going to reduce OFTEL's activity in accordance with the development of competition. If such kind of philosophy is valid, other regulators like OFFER or OFGAS might be also in the future reduced or may vanish. That reminds me of the famous sunset principle in airline deregulation in the United States. Some people now are arguing that FCC itself should be abolished. Can such kind of philosophy explain the development of the U.K. deregulation policy?

YARROW:
i) It certainly was the original plan in telecoms that regulation would be a relatively temporary exercise. That was part of underestimating the difficulties, and I would not expect OFTEL to fade away quickly. I think the future is very open and people are genuinely looking around to see which way regulation is going. ii) The U.K. regulatory offices have expanded in terms of personnel. But a lot of the staff are dealing with things like customer complaints. Rather small group of people are looking at the big public policy issues. The problem is not that the offices have grown but that they were too small to begin with. iii) The state of the antitrust laws in the U.K. is historically very weak, and there has been a compensation for it. What we need to do in the U.K. is not to get too involved in the detail of
how to change regulatory bodies, but to reconstruct the over-arching antitrust laws because, as in the United States, they should be supreme. An interesting angle arises from European integration, because at the Community level the antitrust laws are over-arching, and there is no equivalent of the U.S. state exemption. Brussels can apply the existing antitrust laws of the treaty to these special sectors, and is actually trying to do particularly in the economies such as France and Italy where there is a bigger resistance to reform of the industries. The difficulty is simply that the Commission does not have the resources to handle the caseload that will be necessary to tackle this in a very vigorous way. But on paper the European Union does have this option of enforcing the general antitrust laws and using those as a lever to secure regulatory change in the sectors.

(END OF SESSION 2)
Wednesday, 20 September 1995
9:30 - 12:00

Session 3: Privatization and Deregulation in Japan
Chair: Lewis Perl
Paper: Tsuruhiko Nambu

1. DISCUSSANTS' COMMENTS

HARRIS:
1. Some of the basic lessons is to distinguish the deregulation potential in a naturally competitive industry like trucking and airlines than in a natural monopoly case. In the natural monopoly case, the effort should be to define the natural monopoly to its smallest possible sphere of economic activities, continue to regulate it as little as you need to.
2. What I would like to focus about is much more about the process of change, not so much the solutions. For example, we have repeatedly referenced airline deregulation as if an act passed and signed in 1978 was the whole of it, yet was not. Airline deregulation occurred over a fifteen year period in the U.S. That act was merely the culmination of that process. We move from one state to another state an incremental step at a time. What kind of steps can we take to speed up that process?
3. First: Policy-makers should look for greater opportunities to create opportunities that entrepreneurs can exploit. This isn't about telling people what to do. It's about creating a set of economic incentives that will cause people to think of doing something that maybe you wouldn't have even thought of.

   In looking for such opportunities, I suggest considering the following kinds of effects of small changes. i) The feedback effect. Some kinds of changes can be reinforcing. Look for policy changes that will create their own momentum. ii) The foothold effect. The foothold, the little tiny foothold, that spaced to compete in a tiny sliver of telecommunications, drives to something quite grand. iii) The demonstration effect. Footholds grow into something more substantial because if you give people a chance to gain a foothold in a market, it demonstrates to other entrepreneurs who might imitate, it demonstrates to customers what they have been missing.

   Some of the specific incremental steps are worthy of consideration, anything at all that improves entry opportunities. Entry is not always economic and we should be promoting competition, not individual competitors. But even if it created some short-run inefficiencies, the dynamic gains have far exceeded those static losses.
4. Secondly: Do whatever can be done. Again, it won't happen overnight, but move gradually toward economic pricing, because economic pricing itself is of an important condition of entry.
5. Third: Increase the resale opportunities. Because these are infrastructure industries, we think too much about those who will build facilities. Much of the change in the marketplace comes not from people who build facilities but from people who figure a better way to sell them, a better way to buy them from someone else.

6. Fourth: To promote that, you need to reduce the use and user restrictions. A facility based company that has market power will try to protect that market, make it very difficult for customers who buy for one purpose to use it for another purpose.

7. Fifth: Increase pricing flexibility. Let people discount and package almost without any limits, because it creates this pricing dynamic in the market.

8. Sixth: To increase intra-modal competition. This is possible in all of these industries, but any steps that have the effect of limiting truck-rail competition or gas-electric competition, or telephone or cable, wireless competition in communications services.

9. Last: It does not require breaking up NTT, to impose nondiscriminatory interconnection on NTT. If one looks at the rest of the world, already AT&T is in the process of reintegrating in the local exchange service. The problem with NTT is not that it’s vertically integrated into local exchange and long distance, but that there are not adequate rules that allow other firms to compete with it.

KOJO:

1. First of all, Japanese case proves to be rather odd and strange, because the competitive industry such as airlines and transport industry would be amenable for the relaxation of regulation, but industries where monopolistic nature is strong will find it difficult to deregulate, such as the telecommunications and electricity. Within the picture of the deregulation in Japan, there are three stages involved:

   First stage took place in the early 1980’s, at which time JNR was privatized and the NTT is privatized. Its objective was to help the administrative reform and assist the administrative reform, and also to assist the fiscal reconstruction of Japan. That is why strong force was applied.

   Then at the late 1980’s deregulation was introduced for the livelihood of Japanese public. In spite of the appreciation of the yen, still the prices tended to be remaining high, and it was not contributing to the welfare improvement of the general public. The American Government was also adamant about the Japanese deregulation.

   In the first round, the deregulation and reform had taken place from the top-down method, but the second round of the stage was led by the consensus method. The third stage, I believe, had already begun some time last year. Japanese economy had gone into a recessionary state losing much of its competitiveness internationally and deregulation came inevitable way for Japan to regain her international competitiveness. But the top-down method was not taken for this third stage.

   The Ministry of Transport is passive for the deregulation of the transport industry,
but no external pressure or internal pressure has been applied either. As for the external pressure, mainly deregulation in Japan have been led by the pressure coming from the industry, not the consumers. The privatization of NTT was regarded as a part of the fiscal reconstruction programme of Japan. Then, the electricity deregulation was also going ahead with the deregulation because the strong pressure was applied for the industry.

2. The second point is that in Japan the deregulation in the strongly monopolistic industry has not been going on that well. With regard to the highly monopolistic industries, what has been deregulated so far is the telecommunication and electricity. Electricity has seen the deregulation just recently. In a telecommunication deregulation there were two characteristics to it.

Until about last year, the regulators were looking for the promotion of competition in the long distance market. But the measures applied were the mismatch as a result because one of the measures was the entry regulation. Apart from NTT, three NCCs have come in, but no other NCCs were allowed to enter into this area.

One more point is that in 1994 there was no admission of the rate rebalancing. Last year, subscribers line charge had gone up a bit, so there has been some modification in change. On the other hand, until 1994 there wasn't a sufficient type of the access charge rate structure, either.

Then, with regard to the long distance services, the NCCs had a wide opportunity for getting the cream-skimming of the business. Why was it that MPT had schemed this way? Because MPT wanted to nurture NCCs. In terms of the cream-skimming, MPT people have some image of bad cream-skimming and good cream-skimming. “Bad cream-skimming” is that cream-skimming is fully enjoyed and high profit is enjoyed. “Good cream-skimming” is that cream-skimming would be enjoyed but the nationwide services would be provided. In this case, the promotion of competition was not necessarily the primary objective for the deregulation process.

The next stage is to open up the local market. Because in Japan there is unprofitable universal services and this needs to be maintained, the discussion is whether to provide a fund for it, or make some external funding method or not. The second issue is regarding the tariff. Inclusive of the rate rebalancing, full liberalization should take place. Thirdly, the incumbents will not be the sole entity for bearing the cost or the burden for the universal services.

3. The third point is about the institution of regulation. In Japan, basically the deregulation is being effected on the top-down basis. So far, deregulation has been going on under the leadership of the bureaucrats, but some people say that the Cabinet Department shouldn't be responsible for the deregulation, and that an independent regulatory body should be made. As in the case of the U.K., courts should be competent to control the regulating agencies.
MATSUBARA:
1. In 1980's in Japan three public corporations were privatized. Basically the administrative reform centering around this privatization was successful. However, the reform is still mid-way, and also the administrative and political reform is still mid-way.
2. We have been discussing greatly about deregulation, and also the possible unemployment that could be caused by deregulation. There was a tacit understanding among us that deregulation will cause unemployment, that is to say, regulated industries do have surplus workers. If we look back to JNR privatization, 270,000 employees were reduced to 200,000 employees. In the case of NTT, at the time of privatization, there were 300,000 people working for the Company. Today we have 200,000 people working for NTT. However, NTT created about 37 subsidiaries. Even if the total number of employees decreases, they are just transferring people to subsidiaries. A huge amount of financial assistance as well as capital investment is also made by NTT for the benefit of these subsidiaries. We only need 150,000 people to deliver letters to various areas of Japan. However, just for telephone exchanges we have 200,000 people.
3. From other viewpoints as well, NTT is not necessarily competitive enough today. Inter-city service and intra-city service are integrated by NTT and there is virtually no competition in intra-services market. There is a cross subsidization within the company, and NTT does not have a fully strong competitive edge. We have to break up NTT in terms of intra-city services and in terms of regional franchise. Even if we have a law to allow competition, NTT is still a dominant company in intra-city service, and it is very difficult for new entrance to come into this market and successfully compete with NTT.

2. SPEAKER'S REACTIONS

NAMBU:
1. I agree to the first point that the most important role of government is to create opportunity or economic incentive. We discussed that especially in Europe or in Japan the regulatory body is the combination of regulation and also industrial policy. In case of telecommunications, such kind of state gives us a very serious problem. One is that in the past ten years MPT was eager to protect new entrants. This comes from a very mistaken sense of responsibility. Because the Government invited new entrants into this industry, the Government feels that it has some kind of responsibility to protect these newcomers. The other problem is that the Government is often very conservative or very prudent. They inhibit to take risks of the companies. If one business is very risky, the government says: “No. Don’t enter.” It’s an unnecessary guidance of the Government.
2. The second point is also the government attitude towards industry. In Japan some regulatory ministries are very protective to the business. It has also some kind of historical reasons. In Japan, or maybe in the United Kingdom or in Europe, the government
is always incumbent, business is a newcomer, and the Government often thinks the company as a child. The government also takes some kind of responsibility towards their children and it’s also a most important preventive factor to develop competition in Japan.

3. I agree to some extent to the third point on the number of employees in NTT, but, to be exact, certain percentage of people really went out of NTT. I think the percentage is not so small. At the same time, from the other aspect, such kind of re-employment makes some sense, because telecommunication industry is now encountering a very dramatic change, and new subsidiaries and new products are often produced. I completely agree to the point that NTT is lacking dynamism. It comes partly from institutional stalemate. Always MPT and NTT are discussing to develop new things and it takes so much time.

4. As for the breaking up of NTT, I think it takes so much time. But we don't need any divestiture of NTT. The first reason and most important reason is that in telecommunications new technologies are emerging, especially in the long distance market. NTT network is the bottleneck, but now new technology is appearing, and they can provide us another local telephone network, like wireless or like cable TV. If we go to Sweden, cordless phones or wireless phones are a dominant factor. As for the long distance market, there exists a kind of irony. If long distance market is separated from NTT, three newcomers will be completely destroyed, because there exists huge economies of scale.

3. FLOOR DISCUSSIONS

MARSHALL:

1. In many respects, the re-regulation of telecoms is taking a very different approach this year from the ones that have gone before. There has been a big move by the new Director-General to try to promote arrangements that will encourage more competition. Because BT stood in a very dominant position in many of the services, he has tried, first of all, to introduce perhaps even a new license condition, that would ban anti-competitive practices. The regulators in the U.K. are very much hampered by the fact that there isn't effective general competition legislation and one is often trying to overcome the weaknesses of competition legislation through the individual utility regulations.

2. The other thing that the Director-General is trying to do is to move away from what I call the accounting based regulation to more economic regulation. That is a fairly difficult thing for them to do.

3. The point where I do rather disagree with Bob is about break-up, because one of the things that the Director-General is, saying at the moment is that if his new policies don't work, then he is suggesting some sort of restructuring as a last resort. I am slightly inclined towards break-up, and then, perhaps a reintegration along market lines rather than having the integration associated with a government-created monopoly in the first place.

4. One of the other things that I agree with him about is making small changes.
It's even more important to try to make big changes but make them look as if they are small changes. Because as soon as anybody thinks there is a big change, then you get all the pressure groups lining up to make sure you don't do it.

5. The other point that really I would like to agree with is on access pricing. In terms of the efficient level of access pricing there is still quite a lot to do. But in terms of promoting competition, the most important thing is to introduce nondiscriminatory charges so that the incumbent pays exactly the same as everybody else.

6. Bob spoke about the dynamic gains from competition. There is sort of economics which, at least in England, sees the imperative as actively promoting competition. It is also behind “RPI minus X” where, in a sense, one is trying to harness the profit motive to customers' benefit in the end.

7. One of the issues that keeps coming up is the idea of cream-skimming, and the idea of uneconomic services. When people talk about cream-skimming, what I tend to say to them is that it seems to me that those people who have been most over-charged in the past really rather deserve to have their prices aligned with costs first in the future. A related activity is about uneconomic customers and uneconomic services. This is something that we have had to face very recently in the gas industry. The idea is that you can't open the domestic market to competition, because there are customers such as the elderly and disabled who have special services, and perhaps also other people who don't take much gas. The argument is that it's not at all clear that they are genuinely uneconomic when you take into account the fact that competition will lower the overall cost base. Therefore, there is no particular reason to think they will face price increases.

8. There was some idea about protecting entrants that has particularly happened in telecoms in Great Britain, for instance, there was the very early protection of Mercury. But it isn't true that there has been protection and indeed will be protection in other industries. Again, this is something that we have faced with getting new legislation for the opening-up of gas market. What we have done is to say that we won't actually protect entrants, but that we will protect customers, so that there are arrangements in place that if somebody goes after the market or goes out of business, there will be a bond which they have to put up in the first place, which can be used to make sure that someone else takes over his customers and another arrangement is put in place to actually transfer customers.

TOKUNAGA (EPA):

It seems to me that the most serious issue on the deregulation of telecommunications in Japan is the rationality or validity of the division of NTT. Having heard the arguments about the NTT issue taken in the Councils concerned, the government sectors and political parties, I have gotten an impression that the opinions insisting the division of NTT are based mainly on anti-monopoly policy, but dynamic changes appearing in these ten years have to be taken into account. NTT is now facing strong pressure of
potential competition. On the other hand, NTT is not allowed to enter the international telecommunications business. I am not saying that the division of NTT should be avoided, but I am saying that it is necessary to take telecommunications business more competitive, and that reliable and persuasive theoretical or analytical framework is really needed in order to deal with deregulation policy for telecommunications in Japan.

YARROW:
1. The failure of the first round of liberalization in the U.K. arose because the legislation removed the statutory to entry into industries like gas, electricity and telecommunications. But there remained a very formidable monstertutory barriers to entry. The firms were dominant, and U.K. domestic competition law is very weak. The U.K. approach was to create regulatory bodies which to some extent compensated for the lack of a strong general competition law.
2. But if you compare the U.K. and the U.S., a similar thing is going on through a different institutional mechanism. In both cases what we have is a set of institutions which give a new entrant somewhere to go to get relief from potentially abusive behavior by a dominant firm. In the United States case, it's the general anti-trust laws. Very crudely, it's leveling the playing field to some extent.
3. One of the problems that arises at this point is that we say entry is good. There is a potential problem in doing it the U.K. way, the regulatory way, in that the entrant can be seen too easily as an end in itself. What happens is you get a subtle move across from a policy which is leveling the playing field and creating the opportunities for entrepreneurs to one where in effect the policy becomes protectionist. You allow a few entrants in, and then you nurture them. In order to protect the new entrants, what you classically do is to make the market less competitive, in effect. You have some of the same problem in Japan, that if you allow three or four firms in to compete with NTT in long distance, but say no more, the entry barriers then go up. What we know about that is that the results of that type of deconcentration, which don't get rid of the entry barriers, are disappointing.
4. Let me come to NTT in that case. If NTT is broken up but the institutional structure within Japan remains the same, it will continue to be the case that the new entrant has nowhere to go. My prediction would be that if you break NTT up in those conditions, you would be very disappointed with the results. If, on the other hand, within Japan new structures are created, which allow the entrants access to a policy which will level the playing field and prevent abusive dominance, my prediction would be that the break-up of NTT would again be disappointing in its effects, because it will be relatively unnecessary.

HARRIS:
1. The break-up is likely to make it much less likely of changing the entry conditions. But putting aside that question, if that were to happen, how many local monopolies should we have in Japan? Should we have one, as we have now, or should we
have seven or nine or whatever? Having done that, you are going to have a regulator feeling a
great need to protect each of these seven or nine newly created monopolies precisely because
we just created that condition.

2. When we talk about dynamics, the dynamics has two dimensions to it with respect to
these discussions. One is, as a potential set of benefits you get from change. The other is that
the changes themselves should be dynamically based, that is, not based upon current
conditions, especially with respect to technology. One does not have to look into the distant
future. One can look at what's happening right now in certain countries.

CHAIRMAN:

Looking back at the experience in the U.S., it seems to me that the break-up was the
key factor in promoting the competition that we've got. I mean that in a more dynamic
political sense than in a strict economic sense. There is in all regulatory circumstances the
tendency towards capture and an alliance to be formed between the regulator and the
incumbent. But the break-up meant that there was not just an incumbent with a point of
view but that there were several strong incumbents with diametrically opposed points of view,
particularly as it goes to the issue of access. There is a second sense which goes beyond that
particular controversy, and goes to the whole nature of the regulatory dynamic itself. Again,
without the kind of break-up a political alliance between the regulator and the incumbents is
inevitable. It becomes very difficult on those terms for even dynamic entrants to enter into
capture, and that by breaking up the incumbents you change that dynamic and make it
impossible for the alliance.

ROBINSON:

I agree basically with the Chairman. In the case of the U.K. we have two quite good
examples -- one a success and one a failure -- resulting from either break-up or not break-up.
In the case of electricity, we have managed to promote access by separating out the
transmission system. That's one of the most important things. In the case of gas, we did not.
About ten years ago Eileen and I wrote an article, before gas was privatized, saying the most
important thing that could be done was to have a separate pipeline system, so people could
get access. The government was not willing to go along with that. It has taken years and
years to get competition going in the gas industry, and people who have wanted to enter the
industry have just not been able to get access to consumers.

(END OF SESSION 3)
Wednesday, 20 September 1995
12:00 - 13:10

Session 4: Comparison among the U.S.A., the U.K. and Japan
Chair: George YARROW
Paper: Akira FURUKAWA

PERL (LEAD-OFF):
1. I do think the contrast between the U.K., in which top-down is clearly what's happened, and the U.S. where bottoms-up is what's happened, is important to think about. There is a fundamental reason both why that occurred in that way and why one should be careful about generalizing from bottoms-up. I don't believe in the U.S. we ever had very great faith in regulation in the first place. That has led to two things. First, we have many systems of checks and balances that limit the power of the regulator, and that provided many opportunities for competitors to successfully challenge the regulator and really destroy the fundamental nature of the regulatory system. Secondly, the burden of proof was on the regulator to show that he had a place in the world, and that he had performed a function.
2. The situation in the U.K. was really quite different. There was perhaps no more faith in regulation in the U.K. than in the U.S. at the start of the process. You don't need regulation in a world where industries are nationalized. The top-down part of this in the U.K. was the lack of faith in government controlled industries and the decision to privatize. It was clear at the outset that once you turned it into private hands, the forces of competition would take care of the regulatory problems.
3. What is remarkable about the U.K. innovation is that the commitment to privatize was so great that there was a willingness to privatize even in those industries in which elsewhere around the world there was a profound belief that regulation was necessary; telephones and electricity. The great innovation, and what the U.K. has taught the rest of the world, is that maybe regulation was rather less necessary than we thought.
4. What does all this say for Japan? It seems to me to suggest that this is a bottoms-up process and you should simply stimulate it. It's trying to impose a U.S. environment in a place where it doesn't exist. But the history of regulation in Japan is profoundly different. If Japan can learn from the U.S. and U.K. experience, it is not to specifically emulate, but rather to learn why it has worked there in ways that perhaps it won't work with the same mechanism here, and instead, to institute rather more draconian top-down mechanisms to get rid of what are rather stronger regulatory barriers that exist here.
5. There have been several themes throughout the Conference. 1) To detach the regulator from the government, in particular, to detach the role of the regulator as the promoter of the industry from the role of the regulator as the governor of the industry. This
mixture of regulation and privatization works nowhere. If the government is involved in economic promotion of industry, there should be a separate entity that’s engaged in the regulation of the same entity. 2) The regulator detaches him from the government so that he doesn’t have the broad force of government as his disposal, but rather has a narrow and limited set of functions, which one can at least conceive of disappearing over time. 3) Instituting the British scheme, not the American scheme, that the regulator has a dual function to regulate where regulation is necessary, but to get out of the regulatory business where it is unnecessary, would be a good principle to be emulated here.

NAKAKITA:
1. How could deregulation proceed with the bottom-up method is the standing challenge for Japan. Presently, focuses are on domestic service industry. So far, those areas are regarded as a sanctity, but people are now feeling that market mechanism and forces need to be introduced in this area; otherwise the Japanese economy would its dynamism shortly. Over a long term, because the society is aging, the implications will be serious. Why is it that not much progress has been noted for deregulation? Because regulators, the ministerial authorities, are not saying “yes” to deregulation. With regard to the deregulation, people are all for it in general sense of the word. However, when it comes to the specifics, all the people related oppose to the specific deregulation.
2. There are so many problems found in the financial industry in Japan. In the late 1980’s in the United States, financial market was looked at as one of the pillars for promoting deregulation. Also in the U.K., with the hope to reconstruct British economy, the drastic deregulation was performed for the financial market. In case of Japan, financial market still remains to be a sanctuary, and an unperforming loan is held by many of the financial institutions, and moral hazard is occurring in a great magnitude, but not much of effective measures have been taken so far. The authorities are claiming that no banks would ever fail or go bankrupt, but for the past several months we had seen a few cases of actual bankruptcy of the financial institutions.
3. With regard to the litigation at the court, there is administrative litigation law related matters and also administrative procedures law related matters, which used to pose a problem, but reviewing is now going on so that institutional-wise contents are strengthened. The problem from now on is how to invoke this available system, and how to initiate the system.

JASINSKI:
1. In Central and Eastern Europe the desire to harmonise their legislation with that of the European Union competes with the necessity to do everything at the same time. What is more, although all these countries move from Marx to market, the road and its determinants differ. For example in Poland it was the Antimonopoly Office that managed to establish itself as a relatively independent institution, committed to creation, promotion
and protection of competition. That is why we suggested that it’s Department of Consumer Protection on Monopolised Markets to be expanded and given the role of economic regulator. Interestingly enough, in the U.K., at the beginning of the process of creating its regulatory system, it was the Office of Fair Trading, the antitrust agency, that turned down the offer of performing the roles later given to OFTEL and OFGAS.

2. Since planning is going out of fashion, could perhaps a renamed Economic Planning Agency become the economic regulator, and then follow the planning itself and prepare the ground for effective implementation of antitrust legislation in network industries? Together with the entry conditions, the existence of an independent and committed regulator is absolutely crucial for deregulation to gain and preserve momentum.

NAMBU:
1. I am very fearful if American people or English people clearly understand the meaning of “top-down.” If we take up the process for consensus-making between regulators and regulated industries, we can identify two types: One is electricity, where nine electricity or now ten electricity companies can join in the Shingikai or Research Council to discuss their own fate, whether they should introduce competition or not. It’s not exactly the bottom-up, but at least, the business is involved in making very important decisions. But in case of telecommunications, NTT is not involved in making decisions, especially the most important decision in breaking up. AT&T had the choice when they faced whether it is broken up in what form. The AT&T Chairman could for a long time discuss with DOJ.
2. If the Council is very capable of dealing with problems exactly, there may exist another reason why NTT is divided from the top-down approach. But if you look at the list of the participants in the Council, 50 percent of the people are non-experts in telecommunications. The Ministry itself takes care of all dealings in the Council.
3. The last thing is the transparency. If the break-up of NTT is accompanied by full deregulation, it makes sense. But there exists a very high possibility that NTT is broken up into pieces with very strict regulation upon them. That’s maybe the worst result, and we are well prepared to be disappointed in the future.

HARRIS:
What I am struck by is that I am asked the same question every time I come. Should we break up NTT? A lot of energy that has been spent debating whether we should break up NTT would have been much better spent trying to do some of the other things that will introduce just a little bit more competition than you now have in telecommunications.

ROBINSON:
I have been surprised in a way about the measure of agreement from people outside Japan. There are at least four points. 1) Most people have been very clear that competition is a process, not a state. 2) Regulation should be confined to what appear to be genuine monopoly areas, but one ought to change one’s view as markets and technology
progress as to what those natural monopoly areas are, and so you don't freeze things in stone.
3) It is important to have regulators who are independent of government, and to also have the right kind of incentive structure. The British system does have something to offer in this case. The duty to facilitate competition helps to avoid capture and also the tendency of regulators to want to hand out favours to particular interest groups. 4) When you get down to price regulation, one does need to try to provide the correct incentives for those who are regulated. There is something in the RPI minus X price cap system. I do have some doubts about it, but on the whole it is better than the alternatives.

A very simple change in the name of your Agency would be useful. How about the Economic Liberalization Agency?

KOJIMA (EPA):
1. The subjects of telecommunications, electricity, transportation are difficult areas worth thorough discussions here before taking up the subjects of agriculture and finance. This symposium can be regarded as one of the attempts in Japan, or Japanese bureaucracy, to push through the movement of reform. In that sense, this symposium gave us a great contribution.
2. At the end of this symposium, I have two very deep-seated feelings. The first is the underlying forces of the reform: In the Japanese decision-making system, bureaucrats are required to make consensus of the Council even when we need a change, which is impossible because eventually somebody would get business and somebody would lose business after the change. That reflects something is missing in Japanese society, and that is these individual opinions and individual actions by businessmen and consumers. Those voices are usually hidden underneath the feeling, and the buck is passed to the government bureaucracy, and stops there. I thought that the Economic Planning Agency should be renamed as “Economic Reform and Forecasting Agency”, but the momentum for reform is still not so strong. I would be very glad if we get that momentum and eventually are able to rename it that way.
3. Secondly, based on that more lively, more individualistic, more democratic society, then we can discuss about how to carry out regulatory reform. We have more task to do than you have, because we have more fundamental task of changing people's attitude and the behaviour in the society.
4. Concluding I have learned three key words. First is that reform should be “pro-competitive.” Secondly, the regulatory system or process, should be “decentralized”, or bottom-up. Thirdly, the reform should be a “continuous” process, and it would be a piecemeal change in the continuous process. “Toward a pro-competitive, decentralized, continuous regulatory reform” might be a suitable summary of the symposium.

(END OF SESSION 4)