

JAPANESE SECURITIES MARKETS: THE IMPACT OF THE PRIVATIZATION AND DEREGULATION OF JAPAN'S PUBLIC ENTERPRISES

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1. INTRODUCTION

The development of Japan's capital markets, and the corresponding concerns regarding the current state of regulation of Japanese investment banking and securities trading practices, has attracted a good deal of attention over the last few years, particularly since the size of Japan's domestic capital markets has eclipsed the size of many of its counterparts around the world. One phenomenon that appears to have gone largely unnoticed is the unique contribution made by the monumental privatization efforts undertaken by the Japanese government during the last decade, resulting in the listing of shares of one of the world's largest corporations, as well as the expansion of participation in the securities markets to large numbers of new individual investors and the creation of troublesome conflicts of interest among the nation's legislators, investment bankers and regulators.

This article examines the impact of the privatization and deregulation of certain Japanese public enterprises on the Japanese securities markets. Part 2 provides a brief summary of the rationale for the public enterprise in Japan and the pressure which led to the privatization policies adopted by the government in the early 1980's. Part 3 examines the process of privatization and deregulation in Japan's telecommunications sector in order to discover the groups that have strong vested interests in national telecommunications policies and the effect these interests might have upon trading activity in the securities of Japan's largest telecommunication enterprise. Part 4 describes parallel privatization activities in the airway, railway and tobacco areas. Finally, Parts 5 and 6 provide an analysis of the effects that privatization has had on the development of the Japanese securities markets and investment banking industry.

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2. JAPANESE PUBLIC ENTERPRISES

2.1. Background

In almost every country, there exists one or more sets of goods and services which are considered to be essential to the economic and social welfare of the public. It is in these key areas where government regulation of some type is most visible, particularly as the state attempts to control various aspects of the activity, including entry into and exit from the activity in question, compensation and pricing, the quality and scope of services, mergers and combinations within the industry and financing, in order to ensure the efficient allocation of resources and timely delivery of needed goods and services.¹ Moreover, in industries such as public utilities, postal services, telecommunications and railways,² government involvement may extend beyond mere regulation to the creation of government managed, owned or sanctioned enterprises to provide the specified goods and services.³

In contrast to the United States, where the government has generally limited its intervention into certain public services to regulating the activities of and granting monopolies or exclusive areas of operation to privately capitalized firms, Japan has a long history of utilizing public enterprises to carry out government functions of a social and economic nature, beginning with the government's ventures in the textile, steel and shipping industries after the Meiji Restoration in 1868.⁴ Following

¹ Uekusa, *Government Regulations in Japan: Toward Their International Harmonization and Integration* in JAPAN'S ECONOMIC STRUCTURE: SHOULD IT CHANGE? 237, 242 (1990). For an outline of economic regulation in Japan at the end of 1989, see *id.* at 244-45. The outline identifies disparate types of regulation with respect to entry (*i.e.*, permission, licensing, registration, notification or a legal monopoly) and pricing (*i.e.*, authorization, notification, guidance or legal sanction by the Diet, Japan's national legislature).

² Each of these industries has the characteristics of a natural monopoly in terms of the economics of scale available at the production stage, the economic efficiency of their distribution networks, the scale of the sunk costs of both production and/or distribution, and their utilization of scarce resources. governmental regulations at once sanction such supply-side monopolies (or highly concentrated oligopolies), be they at the national or local level, but at the same time attempt to circumscribe the ways they use their power to dominate their respective markets. *Id.* at 242-43. There are other regulated industries in countries like Japan, such as tobacco manufacturing and sales, where the government's primary objective is to ensure an adequate level of tax revenues. *Id.* at 243.

³ In Japan, these "public enterprises" are of three broad types: (1) governmental undertakings that are operated within the central or local government; (2) public corporations, which operate independently, yet are wholly-owned by the national government (the "government") and regulated by the Diet; and (3) mixed enterprises, which take the form of limited companies and are regulated by the appropriate government ministry. *Id.* at 246.

⁴ PUBLIC ADMINISTRATION IN JAPAN at 37 (Kiyoaki Tsuji ed. 1984).

the end of World War II, Japan established a number of independent public organizations, including large public corporations such as the Nippon Telegraph and Telephone Public Corporation ("NTT"),⁵ the Japan National Railways ("JNR")⁶ and the Japan Tobacco and Salt Public Corp. ("JTS"),⁷ financial organizations which were to provide assistance for imports, exports and overall industrial development,⁸ and "special companies"⁹ such as the Japan Air Lines Co., Ltd.

⁵ NTT was founded in 1952 as a wholly owned government company and was originally modeled after the American Telephone & Telegraph Co. ("AT&T"), including a research laboratory. However, NTT was precluded from manufacturing telecommunications equipment. JAPANESE ECONOMIC INSTITUTE REPORT NO. 32A at 2 (1990) (hereinafter JEI REPORT NO. 32A).

⁶ The JNR was originally formed in 1872 as part of the country's late 19th Century modernization efforts. The postwar national railway company arose from a reorganization of a branch of the Ministry of Transportation ("MOT") in 1949. *Id.* at 1-2.

⁷ JTS was founded in 1949 by merging two government monopolies. *Id.* at 2. NTT, JNR and JTS were referred to as "*Kosha*." "These businesses were once directly run by the national government and financed by special accounts [in the national budget. After World War II,] they were established as independent organizations to perform their business in the form of private concerns. They are fully financed by the government; their budget is subject to the approval of the Diet and final accounts also had to be submitted to the Diet. The employees are granted the right of collective bargaining but [unlike employees of other public corporations,] not the right to strike." PUBLIC ADMINISTRATION IN JAPAN, *supra* note 4, at 38. As of January 1982, *Kosha* had 780,056 of the then-current total of 930,470 public corporation employees. *Id.* at 46.

⁸ These organizations included the *Kōko*, *Ginko* and *Kinko*.

Kōko [such as the Housing Loan Corporation,] are financial corporations which supplement the operation of commercial finance institutions by financing special projects such as agriculture, forest and fishing industries, small and medium-sized enterprises, and housing construction at a policy-oriented rate of interest. They are fully financed by [capital and loans from the government.] The budget and final accounts of *Kōko* were subject to the approval of the Diet, as in the case of *Kosha*.

Ginko [such as the Japan Development Bank and the Export-Import Bank of Japan,] have much in common with *Kōko*: (i) they played a supplementary role to commercial financial institutions, (ii) their capital is fully financed by the national government, and (iii) their budgets and final accounts are under the control of the Diet. However, they enjoyed more autonomy and operate more as enterprises than *Kōko* in that business plans and operational procedures can be prepared without the approval of the competent ministers and internal reserves such as legal reserves are permitted.

Kinko [such as the Central Cooperative Bank for Agriculture and Forestry and the Central Bank for Commercial and Industrial Cooperatives,] are corporations set up for the purpose of financing cooperatives. Both issue bonds to be used as sources for loans [and] maintain strong autonomy in operations due to the fact that, unlike *Kōko* and *Ginko*, they are free from government control in preparing their business plans and budgets.

PUBLIC ADMINISTRATION IN JAPAN, *supra* note 4, at 39.

⁹ These companies, organized as joint-stock companies, were referred to as "Tokushu-Gaisha" and were formed in order to provide public service in fields such as

("JAL")¹⁰ and Kokusai Denshen Denwa Co. ("KDD"), which provided international telephone services.¹¹ The number of public corporations reached a high of 113 in 1967 and although the number of public corporations has not increased since that time, the role of their business operations in the economy has continued to expand.¹²

In Japan, as in other countries, public enterprises are used for those activities which the central government does not want to manage directly, yet are believed to be of such importance to society that it is imprudent to allow them simply to be provided by private enterprises, even if the private firms are licensed and regulated.¹³ Among the rationales for using public enterprises are the following:¹⁴

1. Public enterprises insure a continuous and stable flow of services in essential areas, such as telegraph and telephones, railways and air transport, due to the government's ability to control price and rate structures and to provide a steady flow of financing in the form of capital aid, loans and subsidies. In light of the need to rebuild Japan's economic infrastructure following the aftermath of World War II, government intervention in such key areas as telecommunications and transport became, in effect, a matter of "national security."¹⁵

2. Because they have access to loans from a wide range of government accounts, public enterprises can implement projects that would be difficult to conduct solely with annual government subsidies, such as for

international air transportation, electric power development, international electronic communication, and investment for small and medium-sized enterprises. "Some receive capital and loans directly from the national government, some indirectly, and some receive no aid. Although there are certain legal provisions of government control over their business management, they maintain stronger autonomy than other public corporations." *Id.* at 39-40.

¹⁰ JAL was organized in 1951 as a special private corporation which allowed for some form of private investment, although the MOT's status as the largest shareholder was guaranteed by law. At the time of its privatization in the late 1980's, 34.5% of the outstanding shares of JAL were still held by the government. JEI REPORT No. 32A, *supra* note 5, at 2.

¹¹ KKD was organized under the authority of the Ministry of Posts and Telecommunications ("MPT") in 1953. *Id.* at 2.

¹² PUBLIC ADMINISTRATION IN JAPAN, *supra* note 4, at 37-38.

¹³ Specifically, "public corporations are established by the [Japanese] government by special laws as instruments for activities required by the state, when particular activities are better managed in the form of a profit-making enterprise, when efficiency in performance is more likely to be produced by such an enterprise than under direct operation by the government, or when more flexibility in financial or personnel management is required than is normally possible under the laws and regulations pertaining to government agencies. *Id.* at 36.

¹⁴ The following list of rationales for using public enterprises is adopted from PUBLIC ADMINISTRATION IN JAPAN, *supra* note 4, at 42.

¹⁵ Among the specialized firms were the Housing Loan Corporation, Japan Development Bank, Export-Import Bank of Japan, Medical Loan Corporation and Environmental Sanitation Corporation. JEI REPORT No. 32A, *supra* note 5, at 2.

housing or highway construction. The ability to control these governmental budget accounts provides the various ministries with a good deal of discretion in advancing particular projects and in awarding new contracts for construction and development.

3. Public financing enterprises can provide additional financing resources in areas in which the private sector is ill-equipped to make the requisite policy judgments and resource allocations, such as making loans for enhancing productivity in agriculture, forestry and fishing, promoting small and medium-sized industries and the development of regional industries.

4. Public enterprises are appropriate when either the amount of required capital is too large for private sources or when the venture involves a high degree of risk and a low probability of profits. For example, a public enterprise might be used for atomic energy development, space development or the development of new technology. However, as the economy matures and new technologies are developed which reduce the amount of capital required in order to provide a specified good or service, this argument becomes less compelling.

5. Public enterprises are appropriate when the activity must be performed in a fair and impartial manner, as in inspections and authorizations, although the licensing function can be performed without the need to sanction a monopoly-type structure within the industry.

6. Finally, public enterprises can be more effectively managed to reflect the overall national economic policies of the government. For example, the government may use its influence over public corporations to pursue its goals with respect to price controls, international technical cooperation, promotion of employment and similar matters. Although generally unstated, the public corporation's role as an instrument of industrial policy has proven to be the most difficult obstacle to reforming public enterprises within Japan, even after each of the other rationales has ceased to be applicable.

As a general rule, public corporations in Japan have been operated pursuant to a business plan, budget, and financial plan prepared each year in consultation with the competent ministries.¹⁶ Public corporations might have received capital investment by, or loans from, the government, and were managed by officers selected by the ministries.¹⁷ In turn, the corporations were free to recruit their own employees, although in most cases compensation levels were established by the ministries.¹⁸ The public corporations were usually given some form of exclu-

¹⁶ *Id.* at 43.

¹⁷ *Id.*

¹⁸ *Id.*

sive rights in the business area, although the rate of compensation for services was subject to approval by the government, and profits from business operations were applied first to offset any prior losses with any remaining amount held in reserve, remitted to the government or, if approved by the competent ministries, paid as dividends to investors, if any.¹⁹ In marked contrast to their counterparts in the United States, these firms were able to operate with full government support, with little or no domestic competition in various markets and without the need to satisfy the performance expectations of outside investors.²⁰

2.2. *The Need for Reform*

Little controversy existed regarding the purpose and performance of the public enterprises during the 1950's, 1960's and early 1970's as Japan resurrected its domestic economy and transformed itself into an international trade power. However, as the rate of economic growth began to slow following the twin oil shocks of the 1970's, the public corporations began to show little or no flexibility in dealing with labor unions, establishing new prices or altering services.²¹ Moreover, the profitability of these companies was rapidly eroding, exposing the public to significant potential costs as taxpayers.²² Critics claimed that government backing was actually stifling the ability of the companies to cut expenses and improve services.²³ Whatever the cause, it was becom-

¹⁹ *Id.*

²⁰ For example, AT&T has always been a private company with an obligation to satisfy the expectations of its private shareholder investors, even though a good deal of its activities were subject to government regulation. On the other hand, NTT was subject only to the demands of those government officials responsible for its operations. JAL enjoyed the protection of government-mandated market segmentation in Japan, while private airlines in the United States competed with each other and with international carriers. JNR had no equivalent in the United States until the formation of AMTRAK in the 1970's. JEI REPORT No. 32A, *supra* note 5, at 2.

²¹ In the minds of many people, public corporations were being overcome by inefficient management, deteriorating services and continuous price increases. *OECD Economic Surveys: Japan (1987/88)* at 82 (hereinafter *OECD Japan 1987/88*).

²² The performance of the JNR is often cited as evidence of the excessive burden that the state-owned enterprises have imposed on taxpayers. For example, by 1983 the JNR was losing about \$25 million *daily* and had accumulated short- and long-term debts which exceeded \$120 billion. JNR's annual losses had risen to almost 20% of the nation's annual budget deficit. Sakoh, *Privatizing State-Owned Enterprises: A Japanese Case Study*, Asian Studies Center Background No. 51 (The Heritage Foundation, Washington, D.C., Sept. 4, 1986) at 1-2.

²³ See *OCED Japan 1987/88*, *supra* note 21, at 81-82. In particular, since the public corporations had a mandate to provide public services, even in unprofitable areas, it was difficult for the firms to set and pursue profit or growth objectives commensurate with their counterparts in the private sector. As a result, the public corporations tended to become inefficient, thereby undermining one of the key reasons for continuing government intervention. Part of the problem was the structure under which public

ing clear that the performance of the public companies had fallen behind those in the private sector,²⁴ as well as their counterparts in other areas of the industrialized world.²⁵

Operational concerns about the public companies were exacerbated by a number of difficult fiscal problems confronting the government in the wake of its expansionary policies adopted in response to external political demands in the early 1970's²⁶ and to the recessionary pressures of the late 1970s. The level of government debt, and corresponding interest payment obligations, had risen dramatically.²⁷ In response, in 1979 the government initiated a policy of steady and moderate fiscal restraint,²⁸ including a reduction in the role of investment by

companies operated. First, Diet approval was required for annual budgets and investment plans, leading to blurred management responsibility and impeding the development of an adequate system of independent corporate decision-making. Second, since employment was essentially assured by the government and wages were determined without regard to productivity, it was difficult for the companies to develop appropriate internal incentives. Finally, the absence of competition contributed to continuing operational inefficiencies. Although the public corporations had enjoyed legal monopolies for some period of time, it was believed that meaningful competition could be rapidly created under appropriate conditions. Even in many capital-intensive industries, such as the airlines, potential entry and exit was facilitated by the ease of buying, selling or leasing second-hand fixed assets. In such industries, efficiency could be promoted and excessive profits eliminated by allowing new entrants to challenge large, established companies. In other industries, such as telecommunications, where investment, once committed, cannot be recovered by the sale of fixed assets (*e.g.*, telephone cables), new technology often reduced the importance of economies of scale, making greater competition more feasible. *Id.*

²⁴ JEI REPORT NO. 32A, *supra* note 5, at 2-4. Obviously, there was no real private counterpart to NTT which could be used as a basis for comparison. However, it was becoming clear that private firms, many of which had worked closely with NTT on basic research and product development, now had the capital and expertise to provide some of the services provided by NTT. Also, technological developments allowed "smaller" firms to compete with the services NTT provided through more costly "mature" techniques. *Id.*

²⁵ For example, JNR was characterized as one of the most inefficient and over-staffed railroads in the world and had "several times as many employees per revenue mile as any other railroad system in the industrialized world." *Sakoh, supra* note 22, at 2.

²⁶ In the early 1970s, Japan "was experiencing the very high economic growth rate of about ten percent (10%) annually with low inflation and a trade surplus of \$6 billion with the U.S. The Nixon Administration demanded . . . that Japan stimulate its domestic economy with government spending to increase imports[. Japan] complied by raising wages for government employees and expanding social welfare, public works and other government programs. As a result, the annual budget jumped from 20 percent of GNP in 1971 to 34 percent in 1981. Social security expenditures soared from 4.5 percent of GNP in 1971 to 11 percent in 1981." *Id.* at 3-4.

²⁷ Total government debt had risen to 52% of GNP in Japan by 1984, compared with 47% in the United Kingdom, 45% in the United States and 21% in West Germany. *Id.* at 1.

²⁸ "As a result, the general government deficit has come down from 4.4 per cent of GNP in FY 1979 to 3.0 per cent by FY 1983." *OECD Japan 1985, supra* note 21, at 47. "By the mid-1980s, the *general* government deficit was smaller, as a percentage of

public corporations.²⁹ The government intended to seek further reductions in the public sector deficit by limiting public expenditure over the medium term, reasoning that first, "economic vitality is sapped when the public sector becomes too large; secondly, that the burden of accumulated debt was too heavy; and, thirdly, that the rapid aging of the population would pose severe problems."³⁰

While the government was determined to reduce the overall level of debt,³¹ domestic and international pressure to deal with the perceived problems caused by an excessive structural current account balance was building. For example, the official Okita Report enumerated a number of suggestions for *stimulating* domestic demand, even as the government was tightening its fiscal stance, including simplifying regulations that stifle market focus and increasing investment in the social infrastructure, particularly by the private sector.³² The government also came under a good deal of pressure to reverse its policy of minimizing new investment expenditures.

As a result of these factors, the government undertook a number of studies aimed at solving the nation's fiscal and trade difficulties, including administrative reform and transforming the structure of government activities.³³ The inefficiencies of the public corporations had already led

GNP, in Japan than in most other OECD countries. However, the *central* government still ran a large deficit (3.1 per cent of GNP in FY 1986)[, while c]entral government bonds outstanding amounted to nearly 50 per cent of GNP and gross interest payments were 19.8 per cent of total budget expenditure (FY 1988 budget estimates) . . . [T]he *public sector* deficit - . . . general government plus state enterprises - was also large, amounting to 2.5 per cent of GNP in FY 1986." *Id.* at 33-36.

²⁹ Most of the traditional public enterprises had incurred substantial losses. In order to reduce these deficits, investment by the public enterprises was reduced from over 3 per cent of GNP to 2.3 per cent by FY 1983. *Id.* at 50.

³⁰ *Id.* at 47.

³¹ The government was intent on eliminating "current deficits," which had been funded through the issuance of so-called "deficit-financing" bonds, by FY 1984. However, due to weakness in the economy leading to large revenue shortfalls in 1981 and 1982, the government revised its deadline for eliminating "deficit financing" bonds to FY 1990. *Id.* at 47-48.

³² *Id.* at 53-54.

³³ The Provincial Commission for Administrative Reform (or "*Rincho*", 1981-83) was one of a series of advisory bodies established by the government to consult with the prime minister regarding deregulation during the 1980's. While *Rincho* focused on reducing the size of government through organizational consolidation and the privatization of certain public enterprises, it made little progress with respect to deregulation, other than in the telecommunications sector. The Provisional Council for the Promotion of Administrative Reform (1983-86), convened in an era of heightened trade difficulties between Japan and the United States, concentrated on the improvement of access to the domestic market. The Provisional Council for the Promotion of Administrative Reform (1987-90) proposed the relaxation of a wide range of governmental regulations in both the economic and social spheres, including recommendations for deregulation in wholesale and retail marketing, distribution, information and communications, finance, energy, agricultural produce and new businesses. Uekusa, *supra* note 1, at 252-54.

to a number of suggestions for reform.³⁴ First of all, it was suggested that since the government already had relatively strong control over the business, budget and personnel matters of each corporation and was well-positioned to insure the continued delivery of vital public services, the entities should be given more operational autonomy, mobility and flexibility.³⁵ Secondly, it was suggested that certain of the corporations should be liquidated or reorganized in order to simplify the overall structure of public services.³⁶ Thirdly, it was suggested that management should be rationalized and efficiency enhanced through reductions in personnel, abolition of internal organizations and the implementation of automation efforts.³⁷

The deliberations of a number of ad hoc committees ultimately led to recommendations that NTT, JNR and JTS be reorganized into privately-managed firms in which stock was to be owned by the government and/or private investors, although share ownership by private investors was to be restricted to Japanese citizens.³⁸ Determined to shrink the size of government and limit the risks to future fiscal solvency caused by the continued operation of the state enterprises, Prime Minister Yasuhiro Nakasone, who had taken office in 1982, eventually accepted the recommendations of the committees and undertook to privatize NTT and JTS by April 1985 and JNR by 1987.³⁹ In addition to privatization, which was primarily aimed at reducing the fiscal difficulties associated with the public enterprises, substantial regulatory reforms were to be undertaken, particularly in the telecommunications and air transport sectors.

As discussed in greater detail below, Nakasone was one of the most powerful leaders of the Liberal Democratic Party ("LDP"), which has controlled Japanese politics since the beginning of the post-

³⁴ The Provisional Commission for Administrative Reform had submitted a report in 1964 to the Prime Minister which led to serious consideration of the need to consolidate and reorganize the public corporations. At that time, the government decided to dismantle some of the public corporations whose continued existence was unnecessary and to consolidate those with similar functions. Also, in 1979, a major reorganization program was formulated calling for the abolition or consolidation of some of the corporations. PUBLIC ADMINISTRATION IN JAPAN, *supra* note 4, at 44-5.

³⁵ *Id.* at 44.

³⁶ *Id.* at 44-45.

³⁷ *Id.* at 45.

³⁸ JEI REPORT NO. 32A, *supra* note 5, at 3.

³⁹ *Id.* at 3-4. "Privatize" really had a different meaning with respect to each of the public corporations. For example, as a first step, operational control of NTT and JTS was to be turned over to private management, although the shares of stock were to be owned by the government until plans could be made to sell a portion of such shares to the "public" in order to raise revenues for the government. On the other hand, the government only owned about 35% of the shares of JAL, which were to be sold to the public as part of the divestiture and deregulation process.

War reconstruction period. As Prime Minister and leader of the majority party, Nakasone was able to exercise a good deal of authority over each of the competent ministries involved in the privatization schemes, as well as control the management of each of the public corporations. Moreover, the politics of privatization almost ensured that the future prospects of NTT and the other companies would be linked to internal LDP matters.

2.3. *Implementation of the Privatization Measures*

Nakasone's announced intent to privatize the public companies and deregulate many of the activities previously undertaken by such companies complemented the liberalization that was taking place in the United States and other developed countries in the telecommunications, airlines and financial services areas. Privatization of the public corporations brought with it the promise of improving the government's financial position by increasing revenues and eliminating certain public expenditures,⁴⁰ and providing an opportunity to utilize private funds to fund investment programs which had been delayed or postponed by the government in the early 1980's. However, the impending privatization led to a number of tensions between various sectors of the government and other groups seeking to maintain their own spheres of interest. For example, labor unions delayed implementation of the measures until they had received adequate protections regarding hiring and firing, strike provisions and pension plans,⁴¹ and the companies themselves argued that they must retain an adequate asset base in order to insure an orderly transition and continuity of services. The United States also seized upon the measures, seeing an opportunity to push for increased foreign access to the domestic markets.

⁴⁰ Privatization was anticipated to have a significant effect on estimated tax revenues in the FY 1985 Budget. For example, revenue from the Tobacco Corporation, which appeared as non-tax revenue in earlier budgets, was to take the form of a consumption tax estimated at ¥ 882 billion and the corporation tax to be imposed on NTT was expected to bring in approximately Y 100 billion. *OECD Economic Surveys: Japan* (August 1985) (hereinafter *OECD Japan 1985*) at 32-34. Privatization and limited liberalization also offered the opportunity to reduce government spending without cutting back on services and avoided the political difficulties that would have been created by any attempt to raise taxes to fund the government deficits. Sakoh, *supra* note 22, at 1.

⁴¹ The public corporations had the largest and most powerful labor unions in Japan. The unions argued that privatization would lead to a loss of jobs for their members and would transfer member loyalty from the union to the "new" companies. The attitude of the unions also had an effect on the political process of enhancing opposition to the privatization legislation, since the unions provided the main support for each of the Japanese Socialist Party, which was the second largest political party in Japan, and the Communist Party in Japan. Sakoh, *supra* note 22, at 2.

In light of the intensity of the maneuvering among the disparate interest groups, it was important for Nakasone to forge a consensus package which satisfied, at least to some extent, each of the objections raised. In doing so, Nakasone developed a strategy consisting of the following elements:⁴²

1. *Preservation of Key Services.* In order to alleviate concerns that privatization would materially disrupt the scope and quality of services provided to the public, Nakasone delivered assurances that the government's transfer of the assets of, and management control over, the public corporations would be gradual. For example, the companies would be permitted to operate with most, if not all, of their own existing assets and business, thereby preserving a good deal of the competitive advantage accruing from their capital and asset base. However, in return, the companies would remain obligated to provide the same level of services, including continuing businesses which had proven to be unprofitable when operated as a public trust.

2. *Assurances of Employment.* Private businesses were strongly urged to offer employment to those public corporation employees who voluntarily resigned — an important item in a society in which job security and lifetime employment was a specific objective of almost any type of commercial enterprise. This served to decrease the power of the labor unions to block any of the proposed changes.

3. *Avoidance of Political and Bureaucratic Processes.* Nakasone utilized various advisory bodies and deliberation councils to make recommendations and secure the support of highly-placed and respected officials, thereby hoping to avoid the delays which might be caused by extended parliamentary debate and bureaucratic maneuvering.

4. *Management Support.* Nakasone replaced those executive officers of the public corporations who were opposed to the privatization efforts. In doing so, Nakasone was able to reduce the influence of members of the LDP who had close ties to the "old guard" and who promised to fight any effort to denationalize key industries.⁴³

5. *Public Sentiment.* An appeal to public sentiment was made through the mass media and sought to "educate" consumers and tax-

⁴² *Id.* at 5. The elements listed below are adopted from that article.

⁴³ For example, Nakasone took the unprecedented step of dismissing the President of the JNR and replacing him with his own man. *See id.* Moreover, Shinto Hisashi, President of NTT, became an outspoken advocate of the virtues of privatization for all aspects of the Japanese telecommunications system. *See Shinto, JAPAN Q.*, 380, 380-383 (October 31, 1984). Dr. Shinto was recruited by the *Keidanren* as a candidate for President of NTT in order to promote liberalization internally and to manage the privatization of the firm. Harris, *Telecommunications Policy in Japan: Lessons for the U.S.* at 12.

payers regarding the degree of mismanagement and lack of worker discipline in the public firms, particularly in the JNR.

Nakasone's accommodation of and balancing of most of the competing demands of the ministries, trade unions, foreigners and managers of the subject companies, as well as the interests of the members of his own ruling LDP,⁴⁴ finally led to Diet approval of the various privatization plans, beginning with support of Nakasone's plans for NTT and JTS in 1984.⁴⁵ In 1987 despite strong labor opposition, privatization for JNR, including a large reduction in the railroad's workforce, was finally accepted as the sole means of saving and revitalizing a company crumbling under the weight of excessive levels of debt and personnel.⁴⁶ KDD was to remain a special private corporation, with the government as the largest shareholder, but would no longer be the sole provider of international telecommunications services.⁴⁷ JAL was to be fully privatized through the public sale of the government's remaining stake in the company.⁴⁸ Eventually, foreign firms were to be allowed to join the new domestic competitors of NTT and foreigners were allowed to make significant inroads into Japan's domestic cigarette market.

The government planned to use the anticipated revenues from privatization to finance the domestic expansion called for by critics at home and abroad. For example, the government's budgets for 1987 and 1988 called for sharp increases in the level of expenditures on public works projects⁴⁹ and it was originally announced that most of the ¥ 1.3 trillion interest-free loans for public works would be financed from the proceeds of the NTT offering.⁵⁰ Additional public investment

⁴⁴ Certain members of the LDP actually benefitted to some degree from government control of the public corporations, including the government's ability to allocate any new supplemental services and research projects to certain regions, and fought against the privatization proposals. Also, since a good deal of the support for the LDP came from rural areas, any privatization plan had to insure that rural services were not impaired, even though they tended to be unprofitable. Sakoh, *supra* note 22, at 2.

⁴⁵ JEI REPORT NO. 32A, *supra* note 5, at 3.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 3-4.

⁴⁹ "The draft central government Initial Budget for FY 1988 [provided] that the level of public works spending (which sharply increased in FY 1987) will be maintained. The OECD projections imply that *total* public works expenditure will rise by 1.4 per cent in FY 1988 . . ." *OECD Japan 1987/88*, *supra* note 21, at 36.

⁵⁰ *Id.* at 37. It was originally hoped that the sale of public assets would produce sufficient revenues to assist in meeting the government's bond reduction objectives. *Id.* at 39. However, although the proceeds from the sale of the NTT shares were originally intended for bond redemption, . . . at the time of the supplementary budget in July 1987 it was decided to use part of the proceeds to finance new interest-free loans for [new public works projects]. *Id.* at 110-11.

was to be supplied through the activities of public enterprises, through the Fiscal Investment and Loan Program, and local governments.⁵¹ Thus, the government had a good deal of incentive to accelerate the privatization process and to maximize the value that was to be received from the sale of its interests.

3. THE PRIVATIZATION PROCESS: NTT AND THE TELECOMMUNICATIONS SECTOR

3.1. *Background: NTT and Domestic Telecommunications Services*

While the privatization of each of the major public enterprises in Japan during the late 1980's carries with it a unique set of circumstances and lessons, it is the story of NTT, the sheer size and magnitude of which affected all aspects of the domestic economic and political life of Japan, that is most intriguing and which has captured the attention of analysts. NTT was established in 1952⁵² and, until the deregulation of the industry in the mid-1980's, was the sole supplier of domestic telecommunications services in Japan.⁵³ The decision to grant the monopoly to NTT was based on the belief that the Japanese needed to rapidly reconstruct the telecommunications infrastructure which had been destroyed during World War II, and that this objective would best be achieved without the needless overinvestment which might occur if more than one firm were permitted to compete in the industry.⁵⁴ Moreover, government officials realized that no single firm was then capable of committing the financial resources that would be required to satisfy the demand for services and to build a national network.⁵⁵

⁵¹ Under the initial budget plan for FY 1988, total FILP investment (excluding investment by public financial institutions) was projected to increase by 6.8 %. Secondly, the Local Finance Plan indicated a rise in total expenditure by local government of 6.3 % in FY 1988, with investment up by 11 per cent. *Id.* at 39.

⁵² The enabling legislation for NTT was the *Nippon Telegraph and Telephone Public Corporation Law* (Law 250, 1952). Cole and O'Rourke, Project Managers, *Telecommunication Policies in Seventeen Countries: Prospects for Future Competitive Access*, U.S. Department of Commerce (NTIA-CR 83-24) (May 1983) at 138. Most of the Ministry of Communications was transferred to the new public corporation, except for regulatory functions, which were transferred to the MPT. Harris, *supra* note 43, at 6.

⁵³ Nambu, *Deregulation in Japan* in CHANGING THE RULES 147, 152. International telecommunications services were supplied through KDD, a monopoly public corporation to which NTT transferred its own international division in 1953. *Id.*

⁵⁴ Japanese officials wanted to standardize the nation's telecommunications network and provide complete direct distance dialing service nationwide, all as part of its overall objective to equalize access to telecommunications services. *Id.*

⁵⁵ *Id.*

Originally, NTT's structure was modelled after AT&T, in that it was an integrated provider of local and inter-exchange telephone services, although unlike AT&T, NTT was not vertically integrated into equipment manufacturing.⁵⁶ Instead, NTT used its massive procurement needs as incentives to various "NTT family members," such as NEC, Hitachi, Fujitsu and Oki, to undertake substantial research, design and development projects in the telecommunications area.⁵⁷ By law, NTT and its international counterpart KDD, were given absolute control over all aspects of the design, construction, operation and maintenance of the telecommunications infrastructure in Japan.⁵⁸

At the time that NTT was founded, it had 1.37 million subscribers and the unfilled demand for access amounted to 340,000 subscribers.⁵⁹ However, due to the tremendous growth in Japan's economy and corresponding growth of its service requirements, by 1970 demand had grown to 2.91 million potential subscribers.⁶⁰ As a result of a series of five-year construction plans, by 1977 NTT was finally able to satisfy the demand for services and, by 1979, had achieved its other main objective of nationwide service.⁶¹ By 1984, NTT had nearly 44 million subscribers.⁶² The rapid growth in the subscriber base was particularly acute in the residential sector and by 1984, residential telephones accounted for about 70% of total telephones, up from only 25% of the

⁵⁶ Harris, *supra* note 43, at 7.

⁵⁷ *Id.* While Japan has relied, to some extent, on telecommunications technology developed in the United States, including a close working relationship with Bell Labs, NTT and its family members have also expended considerable amounts on basic research and development. By 1984, Japanese telecommunications technology was roughly equivalent to that of the United States and family members had emerged as global competitors in components, computers and communications technology. *Id.* at 9-10.

⁵⁸ The basis for this control was the Wire Telecommunications Law of 1953 and the Public Telecommunications Law of 1953, which were to remain in effect until 1984. *Id.* at 7-8. The laws did permit private construction of wire facilities, so long as they were not used for third-party communications, although approval from MPT would be required if any such facility would in any way affect the public network. Since Japan is so narrow, and such a large portion of the population resides in the Tokyo-Osaka corridor, MPT concerns about "frequency congestion" effectively limited the spread of private wire facilities to entities such as the Japanese National Railways (for train control) and to the Ministry of Construction (for traffic management on national highways). *Id.* at 8 and n.14.

⁵⁹ Nambu, *supra* note 53, at 152. The ratio of subscribers to the total population, referred to as the "diffusion rate," was 1.8%. The ratio of residential subscribers to the total number of households, referred to as the "penetration rate," was about 0.6%. *Id.*

⁶⁰ *Id.* The annual growth rate of subscribers, including unfulfilled demand, was about 14% from 1952 to 1970, while real economic growth during that period was about 10%. However, the diffusion rate and the penetration ratio increased to 15.7% and 25.4%, respectively, by 1970. *Id.*

⁶¹ *Id.* at 153.

⁶² *Id.*

total telephones in 1960.⁶³ It was observed that the growth in personal income and the desire for more convenient services in the household sector greatly contributed to the enhanced emphasis on residential services.⁶⁴

NTT's total revenues in 1984 had reached 4.75 trillion yen, including 2.5 trillion yen from telephone calls, 990 billion yen from basic fees and 380 billion yen from private-lines.⁶⁵ Even though the volume of long-distance calls accounted for only 27% of the total volume of calls in that year, long-distance revenues contributed more than 76% of the total revenues from telephone calls, thereby suggesting that long-distance revenues were used to cross-subsidize basic fees and the provision of local services.⁶⁶ The existence of such a cross-subsidy was not surprising in light of the wide disparity that had traditionally existed in the prices for local and long-distance services, with the ratio of the most expensive long-distance service (in the daytime) more than double that which existed in the United States, West Germany and France.⁶⁷

The momentum for privatizing NTT and liberalizing the entire Japanese telecommunications industry came from a number of disparate forces which collided during the 1980's. Prior to the sweeping changes in 1985, two significant amendments had been made to Japan's telecommunications laws. In 1971, NTT's monopoly over terminal equipment, other than the "first phone," was eliminated under amendments permitting the connection of PBX's to the NTT network through leased circuits.⁶⁸ NTT was authorized to provide data transmission services over leased lines or public circuits.⁶⁹ However, there

⁶³ *Id.*

⁶⁴ *Id.* at 154. Expressing the growth in the telecommunications sector as a function of the demand for calls, the volume of three-minute calls grew at an annual rate of 8.1% between 1977 and 1984, including a 10% annual growth rate between 1980 and 1984. The annual growth rates for local calls exceeded comparable increases for long-distance services, which reflecting the growing ratio of residential-user demand to total demand and the fact that long distance demand might be satisfied by various "substitutes," such as private-line and data communications services. *Id.* at 153-54.

⁶⁵ Nambu, *supra* note 53, at 155.

⁶⁶ *Id.*

⁶⁷ *Id.* at 154, where it is noted that, until 1980, the ratio stood at 72 to 1, which far exceeded the ratio of the actual costs of such services, as well as comparable ratios of around 15 to 1 in the countries cited in the text. The ratio was reduced as a result of NTT's attempt to lower the price of long-distance services beyond certain distances; however, the ratio still stood at 40 to 1 in 1984. NTT's rate structure until the mid-1980's is summarized in Nambu at pages 154-55 and reflects pricing of long-distance services at well above average costs while the basic fee and price for local calls is far below average cost. *Id.* at 154-55. For an economic analysis of the policy choices associated with reforms to NTT's rate structure, see *id.* at 158-173.

⁶⁸ Harris, *supra* note 43, at 8.

⁶⁹ *Id.*

was no authorization for value-added services and third-party providers of data processing services could not transmit data over leased circuits.⁷⁰ But, in 1982, further amendments authorized privately-operated data networks ("VANs"),⁷¹ although by that time NTT itself was substantially involved in providing large-scale value-added services, such as on-line reservations systems and financial information services.⁷²

At the same time, a number of other factors were operating toward some form of change in NTT's role and structure. First of all, MITI and the MPT continued their ongoing "turf fight" in the development of the data processing industry in Japan, which had raged since the prior decade. Second, pressure was coming from the United States for liberalization of prior restrictions on imports of telecommunications products into Japan. Third, a number of large domestic companies had concerns regarding NTT's announced goal to develop the Information Network System, or "INS," which was to be a single network that would provide data, voice and video transmissions⁷³ thereby making

⁷⁰ *Id.* at 8-9.

⁷¹ *Id.* at 9. Although prior notification to the MPT was required, privately-operated VAN services were permitted among closely-affiliated groups of small or medium-sized users and essential links between manufacturers, wholesalers and retailers were permitted. *Id.*

As of July 1984, 39 companies had filed with the [MPT] requesting approval for 46 systems [under the regulations with respect to VAN services.] Many of the systems are for the exchange of messages within a company and with its affiliates, or else are part of rationalization efforts designed to minimize communications costs. . . . [C]ompanies operating VANs include data processing firms like Intex and Japan Electric Computation; major computer manufacturers such as Fujitsu and Nippon Electric Co., both through affiliates; Japan Information Service, an affiliate of Sumitomo Bank; Nomura Computer Systems, which is affiliated with Nomura Securities, Mitsui group's [sic] Mitsui Information Development and Seibu Information Center, connected with the Seibu Distribution Group.

Toshio, *The New Media Nebula*, JAPAN Q. 384, 385-86 (October 31, 1984).

⁷² Harris, *supra* note 43, at 9. In the United States, AT&T was forbidden from engaging in data processing and enhanced information services activities. *Id.*

⁷³ The INS, which arose out of technical innovations in the areas of large scale integration, digital switchboards, optical fibers and communications satellites, was intended to integrate the various communications networks which were then structured in accordance with different kinds of services, through the use of rapidly changing advances in digital technology and other fields. As such, NTT anticipated that it would be able to provide not only telephone services, but other services such as facsimile and data communications. As a result, NTT would be able to provide the consumer with more services at a lower cost, and in a more convenient manner, with distance-related differences and charges reduced to a minimum. The system would serve as the basic infrastructure of the emerging sophisticated information oriented society. Shinto, *supra* note 43, at 383. Initial test services of INS would focus on target households in the Tokyo area and would begin by supplying information from 320 financial institutions, trading firms, retailers and the mass media. Toshio, *supra* note 71, at 387.

any existing investment in "VANs"⁷⁴ redundant and crippling the plans of the railways and power companies, who owned and operated their own telecommunications systems, to sell spare capacity.⁷⁵ In addition, NTT's ability to effectively cross-subsidize other activities made it a powerful potential competitor of computer services companies and equipment manufacturers.⁷⁶ Finally, as discussed above, privatization of NTT became an important element of the government's fiscal policies.

Serious consideration of deregulating the domestic telecommunications industry began in 1980 when the MPT established a Telecommunications Advisory Council. The Council's report, "A Vision of Telecommunications Policy in the '80s," took note of the rapid technological progress, more sophisticated and diverse user needs, and the growing dependence of the nation upon information. The report recommended that Japanese telecommunications policy seek greater regulatory flexibility, distinguish between monopoly and competitive services, increase cooperation with the private sector, improve delivery of data transmission services, and develop a new integrated network.⁷⁷

⁷⁴ In 1983, the estimated market for private VANs was \$700 million and the then current projections estimated that the value of the market would increase to \$4 billion by 1990. HILLS, *DEREGULATING TELECOMS: COMPETITION AND CONTROL IN THE UNITED STATES, JAPAN AND BRITAIN* 138 (1986). Given the potential growth in the VAN market, particularly when compared to the domestic telecommunications market, other private companies, such as the equipment manufacturers, had come to covet access to the VAN market, as well as to the expanding computer services area. This desire was particularly acute given that the manufacturers were no longer dependent upon business with NTT. In fact, NTT itself had begun to sell new telephones into the "first telephone" market, over which it still held a monopoly. *Id.*

⁷⁵ INS would also have enhanced the power and authority of the MPT at the expense of MITI by reducing, if not eliminating, the influence of MITI in the important data processing and information services sectors. *Id.*

⁷⁶ NTT's 1983 net earnings of \$1.5 billion, as well as the 14% annual growth in data communications and leased circuit revenue, made NTT a prime target for criticism by those private companies seeking to enter the market and to establish their own nationwide or company-to-company VAN networks. NTT ANN. REP. (1982-83), at 36, reported in HILLS, *supra* note 74, at 139. The litany of complaints about NTT ranged from dissatisfaction with the high trunk call charges, NTT's monopoly of the "first telephone," to the lack of customized billing, and a general feeling that NTT had become too bureaucratic and unresponsive to industry and was no longer sufficiently driven by the demands of the marketplace. HILLS at 139. The cost of long-distance transmission and value-added services had declined relative to the cost of basic local services. However, since the Diet, which recognized the value of low-cost residential services, set telephone rates, large users of long-distance services grew concerned about the size and economic effect of cross-subsidization from businesses to residences. Therefore, large business users, led by the *Keidanren*, began to push for further liberalization of the private network and VAN capabilities afforded by the 1982 changes. Harris, *supra* note 43, at 11-12.

⁷⁷ Harris, *supra* note 43, at 13.

3.2. *The Privatization and Deregulation Debate*

The first formal proposals for the privatization of NTT arose out of the deliberations of the Second Ad Hoc Commission on Administrative Reform (the "Commission"), which was chaired by Toshio Doko, who had previously headed *Keidanren*.⁷⁸ The Commission was formed in 1981 "to study the efficiency of government agencies and operations."⁷⁹ The Commission's report, which set forth a number of recommendations regarding NTT, was presented to the government in July 1982, although the final report was not to be submitted until March 1983. In its report, the Commission recommended the following:

1. *Operational Restructuring.* NTT was to be split into regional operating companies, which would service local exchanges and subscribers. The main, or "national," element of NTT would continue to be responsible for research activities⁸⁰ and long-distance calls.⁸¹ The "new" NTT would have a structure similar to that of AT&T before its deregulation, although NTT's lack of international services made a true comparison between the forms more difficult.⁸² While it is not clear why the AT&T structure was chosen, other than the fact that it permitted the Japanese to borrow from the prior experiences of deregulation.

⁷⁸ Prime Minister Zenko Suzuki appointed the Commission for a two year term in 1981 for the purpose of reviewing the civil service system and government deficits and recommending measures relating to streamlining administrative procedures and reducing costs into the next century. While the original goal of the Commission was to effectively replicate the parallel efforts of the Reagan era and the Thatcher government by reducing the numbers of civil servants, NTT's profitability quickly made it an additional target for review, particularly in light of the concerns of large businesses and MITI's belief that liberalization of the telecommunications area would allow it to recoup some of its authority in relation to the MPT. HILLS, *supra* note 74, at 139.

⁷⁹ Harris, *supra* note 43, at 13-14.

⁸⁰ Although much of the NTT's role in the technological development of telecommunications services (including communications equipment) had been gradually transferred to equipment manufacturers belonging to the so-called "NTT family" (NEC Corporation, Fujitsu Ltd., Oki Electric Industry Company, Hitachi Ltd.), NTT still played a leading role in this field, especially in the area of basic research. NTT spent 91 billion yen on research and development in fiscal year 1983, which represented 27% of total research and development expenditure (including spending by the Government) in this sector. In the early 1970's, NTT's share of research and development expenditure in the telecommunications sector had exceeded 50%. In the United States, the ratio of federal expenditures to total expenditures for research and development in the communications equipment industry was about 0.4 in 1980, according to a National Science Foundation survey. Nambu, *supra* note 53, at 157.

⁸¹ HILLS, *supra* note 74, at 140.

⁸² *Id.* NTT also did not have an independent manufacturing capability, as did AT&T. NTT had begun to sell, rather than rent, telephone equipment to its subscribers, thereby competing with the marketing organizations of those companies from which NTT had purchased the equipment. The fact that NTT continued to control the "first telephone" made its marketing activities particularly threatening to the equipment manufacturers. *Id.* at 138.

lation in the United States, it is possible that there was some belief that the new structure would make it more difficult for NTT to cross-subsidize activities in those areas where new competition was anticipated.⁸³

2. *Privatization.* NTT would be privatized over a period of five years, commencing with the formation of a new special corporation whose stock was initially to be held by the government. Over the five year period, the government would sell off its stock in the central "long-lines" company, which itself would be selling off stock in each of the regional operating companies.⁸⁴ It was believed that the prospect of privatizing NTT would lead to new investment in the telecommunications and data processing areas as competitors began to enter markets previously held by NTT⁸⁵ and new markets arising out of new technologies and the needs of large company subscribers. Ideally, from a capital markets perspective, new funds would begin to flow into the telecommunications area, just as had been the case in the United States when the possibility of an AT&T "break-up" was announced.

3. *NTT Responsibilities.* "The central [NTT] was to be responsible for construction, maintenance and operation of the basic trunk lines, to own and run the telecommunications laboratories and to provide local corporations with technical advice."⁸⁶ Over time competitors would be licensed to enter the basic trunk area.⁸⁷ Also, it was recommended that NTT carry out a number of "rationalization" plans, such as reducing the number of employees, and that NTT should improve certain of its existing services, such as maintenance and repairs.⁸⁸

After the Commission published its report in July 1982, it was referred to the Telecommunications Policy Committee within the LDP.⁸⁹ Privatization and liberalization were billed as a means on increasing NTT's efficiency, allowing the redeployment of workers into new sectors.⁹⁰ Advocates of the new proposal argued that NTT had, in

⁸³ *Id.* at 140.

⁸⁴ *Id.*

⁸⁵ Although it was anticipated that NTT would have competition regarding many of its existing services, most analysts believed that the Japanese telecommunications market had reached maturity in many areas. As such, new competitors were likely to focus upon the opportunities created by the convergence of telecommunications and data processing. *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 140-41.

⁸⁹ *Id.* at 141.

⁹⁰ Many analysts believed that NTT had too many employees. In fact, it was proposed that NTT should reduce its workforce from 320,000 to 230,000 over fifteen years. Similarly, concerns had been raised regarding the dependency (90%) of NTT on revenues from the "mature" telephone market. *Id.* at 142. Presumably, a government-directed company lacking diversification and running with inefficient personnel prac-

fact, completed its designated task of reviving the telecommunications infrastructure of Japan; there were no waiting lists for telephones and the basic network had been put in place. As such, it was now time to turn over any further growth and development to the private sector.⁹¹ However, it came as no surprise that the reactions to the proposals of the Commission were decidedly mixed, reflecting many of the tensions which existed among large and small businesses, labor, and government officials regarding Japan's overall policies for domestic development and international trade.

The *Keidanren*, which generally represented the interests of the larger companies in Japan,⁹² seized upon the Commission's recommendations as a basis for arguing for complete liberalization of line usage for voice and data communications, termination of NTT's monopoly over the "first telephone," divestment of NTT's computer services business, limiting NTT to the supply of communication circuits.⁹³ On the other hand, the *Keidanren* was willing to allow for an easing of the burden of regulation on NTT at the time it was to be converted into a stock company.⁹⁴ While *Keidanren* had originally been supportive of the planned "break-up" of NTT, it ultimately agreed to a compromise which would not include a "break-up," but rather would call for a further review of NTT's position after five years in the new liberalized environment.⁹⁵

The Communications Industry Association of Japan ("CIAJ") represented 178 companies which manufactured equipment for use in the telecommunications market.⁹⁶ While the CIAJ had provided its testimony to the Commission in favor of the notion of privatizing NTT, the manufacturers remained concerned about the effect that the scheme might have upon the conduct of research activities and the manner in which any new technologies might be transferred within private industry. At that time, NTT undertook basic research while private manu-

tices was inconsistent with any effort to reduce budgetary deficits.

⁹¹ *Id.* at 143.

⁹² At the time, *Keidanren* represented over 800 companies, including such industrial giants as Toyota, Nippon Steel and Tokyo Electric. It also had about ten foreign companies among its membership, including NCR, Olivetti, IBM and Phillips, as well as NTT and KDD. NTT and KDD, however, could not participate in any deliberations regarding telecommunications policies. *Keidanren* had its own Telecommunications Policy Committee, of which IBM was one of its members, and had testified in favor of privatization to the Commission. *Id.* at 141.

⁹³ *Id.*

⁹⁴ *Id.* at 141-42.

⁹⁵ *Id.* at 142.

⁹⁶ *Id.* at 141. The CIAJ was dominated by relatively small manufacturers; 44% of its members at the time had an annual turnover of less than \$500,000 and only 33 of its members had an annual turnover which exceeded \$2.5 billion. *Id.*

facturers were responsible for developmental work. Since members of the "NTT family" did not have to pay a fee to NTT for the use of patents for technology developed during the course of NTT's basic research, certain members of the CIAJ were concerned that a privatized NTT would then attempt to sell or license the patents for profit.⁹⁷ Also, some wondered whether NTT would begin to focus on "short-term" research if it was privatized, thereby forcing private firm competitors to bear the expense of long-term research projects.⁹⁸

NTT management, led by President Hisashi Shinto, who had strong ties to the *Keidanren*, and its trade union, Zentsu, also needed to formulate their views on the proposed changes. Although privatization was a disappointment to those within NTT who favored the development of Information Network Services ("INS"),⁹⁹ top NTT management came to see the new changes as a way to achieve more managerial autonomy through freedom from Diet control over budgetary matters, as well as a means for moving away from the stagnating telephone market into some of the new opportunities provided by data and information systems.¹⁰⁰ However, NTT management had little tolerance for the "break-up" into local and long-line companies, arguing that limiting NTT's financial base to that which might be provided by a pure long-lines business, with competition, would cripple the firm's ability to provide any form of INS or finance any of its ongoing responsibilities.¹⁰¹

Zentsu, which appeared to have done a good deal of the actual lobbying on behalf of itself and NTT management, shared the concerns of NTT management regarding a "break-up" scenario. As for privatization in general, it offered NTT employees the opportunity to be

⁹⁷ *Id.* On the other hand, manufacturers hoped that a privatized firm would be free to purchase equipment from Japanese suppliers, as had historically been the case, without being required by government mandate to enter into guaranteed procurement agreements with American firms as part of the ongoing trade debates between the two countries. *Id.*

⁹⁸ *Id.*

⁹⁹ *See id.* at 143. Specifically, planners believed that privatization would foreclose development of the INS on a nationwide basis as a public service. *Id.*

¹⁰⁰ *See* Shinto, *supra* note 43, at 380-83. According to Shinto, reform was required for a number of reasons:

The needs of users have become sophisticated and diversified. The advent of a variety of new media, such as optical fibers and communications satellites, has diminished the need to seek merits of scale through integrated planning and construction [and] there is a need for the invigoration of Japan's telecommunications business and greater stress on internationally competitive interfacing.

Id. at 380.

¹⁰¹ *See* HILLS, *supra* note 74, at 143.

free of the "no-strike" clauses imposed on members of the Japanese civil service and would also permit wage levels to be set without regard to retaining parity with other ailing business which may be run by the government, such as the JNR.¹⁰² On the other hand, privatization exposed NTT and its employees to the "risks" of competition.¹⁰³ As such, if NTT was actually going to become a private company, employees wanted to participate as co-owners of the business and were in agreement with NTT management that ministerial control over the "new" company's activities, at least beyond basic telephone tariffs and the requirements that were to be established regarding the provision of universal service,¹⁰⁴ should be minimized, leaving decisions by NTT to enter into any new business area to the discretion and commercial acumen of NTT.¹⁰⁵

However, fear among the members of the ruling LDP, particularly those members from the rural areas, regarding the uncertainties of a wholesale "break-up" of NTT, ultimately led to a shift in position toward a restructuring without a "break-up," at least in the near term.¹⁰⁶

¹⁰² See *id.* In 1983, the Government had frozen the pay award of NTT employees, presumably to maintain parity with wage levels paid to employees of other public corporations, such as the railway workers. *Id.*

¹⁰³ *Id.* Just how large those "risks" might be in relation to the "status quo" appeared to be subject to some debate. As noted above, *supra* note 90, NTT already had announced plans to reduce its workforce by almost 30% over the next 15 years. NTT was also being criticized for rising personnel costs and the short working week (thirty-seven hours ten minutes) in relation to the manufacturing industry. *Id.* at 142. Since Zedentsu was a "company" union, privatization provided a good opportunity for the union to maintain its strength within the trade union movement, since NTT's ability to provide new services would allow it to redeploy, rather than layoff, existing union members and to add new employees as well. *Id.* at 144. NTT management intended to assure workers of job security by expanding NTT's scope of business and adopting a flexible investment policy to establish new enterprises within the new NTT structure. Also, through effective staff employment and reduction in the number of workers dependent on revenue from the use of communication lines, NTT hoped to lower overall personnel and other costs. Shinto, *supra* note 43, at 383.

¹⁰⁴ Zedentsu did favor a continuation of NTT's obligations to provide universal service and was opposed to the unconditional entry of new competitors. See HILLS, *supra* note 74, at 144.

¹⁰⁵ See *id.*

¹⁰⁶ *Id.* Since MITI had primary responsibility for managing large-scale research and development projects and for directing Japan's export-driven economic policies, it had a strong interest in the possibilities created by the growing competence of Japanese firms in the telecommunications area. In particular, MITI was successful in pushing for the implementation of national policies based on pursuing technical advantage in the areas of information systems. These aspirations, as well as the interests of those firms which were denied access to the NTT family, such as Toshiba and Mitsubishi Electric, led to a groundswell of interest in bringing some form of liberalization to the telecommunications industry. Harris, *supra* note 43, at 11. At the time, MITI's authority was under a good deal of pressure, both from changes in the domestic environ-

Among the ministries, the reaction was mixed. MPT was initially hostile to the proposals; however, changes in personnel at MPT ultimately led to a belief that some form of reorganization would allow MPT to reestablish some authority against MITI, which had always held greater "prestige," and against NTT itself under whatever form of regulation was to be imposed on the new entity.¹⁰⁷ From MITI's perspective, the best result would have been a complete privatization and "break-up" of NTT, since such a policy would have placed telecommunications and data processing completely outside of the scope of MPT and into the "free market," where MITI would then be able to exercise its traditional role in guiding domestic and international competition.¹⁰⁸

In summary, the various constituencies seemed to be settling upon an imperfect compromise, one in which each of the parties realized some, but not all, of their objectives. Among the items which appeared to be necessary in any form of legislation on the subject were (1) a sufficient amount of deregulation to permit large companies to mount competitive efforts in the growing market for information and data processing services, if for no other reason than to permit the development of private networks,¹⁰⁹ (2) a commitment that NTT would be

ment and from international factors. At home, the liberalization of the domestic financial and monetary system, as well as the growing ability of the large firms to operate in international export markets without assistance from the government, had crippled many of MITI's own traditional tools for guiding industrial policy. From abroad, the United States and other Western countries were pressuring MITI to abandon its policies of protecting domestic markets by threatening to impose protective barriers of their own. As such, MITI was forced to become an advocate of liberalizing domestic markets in order to insure that export markets remained open for Japanese goods. *See HILLS, supra* note 74, at 142. Telecommunications came under the jurisdiction of the MPT while MITI exercised control over the computer and data processing industries. In referring to such systems, the MPT was careful to call them "data communications systems" while MITI referred to them as "online information processing systems." The conflict between the two ministries was evidenced by MITI's objection to the creation of a new communications policy bill within the MPT and to the naming of the bill's technological development planning section. In addition to its struggles with the MPT, MITI was also engaged in conflicts with the Agency of Cultural Affairs over whether or not computer programs ought to be protected under copyright laws, as advocated by the Agency of Cultural Affairs, or made the subject of a new law which would better suit the autonomy required by MITI. *See Toshio, supra* note 71, at 388.

¹⁰⁷ *Id.* at 142.

¹⁰⁸ *See HILLS, supra* note 74, at 144. Zendetsu was particularly effective in convincing rural members of the LDP, who held a dominant position in the Diet, that any "break-up" into regional operating companies would have an adverse effect on rural telephone services. As such, the LDP became convinced that the "break-up" strategy should be abandoned and that the final proposal should include a commitment to keep local tariffs steady. *See id.*

¹⁰⁹ Concerns remained that NTT's size would allow it to cross-subsidize activities in the information services area, thereby making it very difficult and expensive for new competitors to enter the market. Obviously, some form of "break-up" would have had the effect of alleviating these concerns; however, as a middle ground NTT's data com-

required to continue to provide some form of basic services, even though it was recognized that cross-subsidization would continue, (3) a moratorium on any full "break-up" of NTT for at least five years, (4) continued ministerial control over tariffs and market entry, although the degree of control which might be exercised by the MPT was somewhat uncertain and (5) some accommodation of the desire of the unions to obtain the partial benefits of some form of strike clause as well as assurances of redeployment.

Following the lively debate in Fall 1983 and early 1984, three bills were submitted to the Diet for consideration in April 1984.¹¹⁰ The legislation included the following elements:

1. NTT would be privatized but it would not be "broken-up" into regional operating companies or into functional divisions. Review of the organizational structure would occur after five years, at which time a "break-up" could once again be considered.¹¹¹

2. Strikes would be limited to 15 days, a setback for Zendentsu. However, since NTT would not be forbidden from doing such things as manufacturing new equipment, the trade unions could reasonably believe that new jobs could be found for NTT's existing employees, thereby reducing the danger that the union would lose members as a result of the restructuring.¹¹²

3. MPT would control NTT's entry into new services, as well as the level of tariffs.¹¹³ Competition would be permitted in local networks, as well as on long-distance lines, although NTT and its competitors would be subject to regulation by the MPT.¹¹⁴

Allowing for regulatory control of NTT by the MPT seemed to be an attempt at achieving some sort of compromise between those constituencies, including MITI, some members in *Keidanren* and the Commission, which favored a full "break-up" of NTT and those groups who favored the continuation of NTT as a public corporation or, at the very least, a private corporation with a monopoly in various telephone and telegraph services.¹¹⁵ However, the degree of control that was to be

munications division was reorganized as a separate corporation, the NTT Data Communications System Corporation, in 1988. Nambu, *supra* note 53, at 151.

¹¹⁰ One bill would privatize NTT, one bill would liberalize regulation of the telecommunications market (the "Telecommunications Business Law") and the other bill would modify almost 100 other laws which would be affected by the structural changes contained in the first two bills. Harris, *supra* note 43, at 14.

¹¹¹ See HILLS, *supra* note 74, at 144.

¹¹² See *id.*

¹¹³ *Id.*

¹¹⁴ *Id.* at 144-45. The Commission had originally recommended that competition only be permitted on long-distance lines. *Id.* at 144.

¹¹⁵ *Id.*

vested in the MPT, as well as the limits on strikes, led to initial opposition by Zendentsu, which proceeded to align itself in the debates within the Diet with the opposition Socialist and Communist parties.¹¹⁶ For their part, manufacturers of telephone equipment also became concerned about the legislation, fearing that NTT would begin manufacturing in direct competition with the manufacturers.¹¹⁷

Throughout the summer of 1984, the various groups mulled over a number of compromises. MPT's control over new services was eased and although the prohibition on strikes during a period of forced arbitration was retained, agreement was reached that the issue would be reviewed in three years.¹¹⁸ With these concessions in hand, Zendentsu, eager to be viewed as a "responsible" trade union and willing to return another day to address the "no strike" issue, reversed its position and came out in favor of immediate passage of the bill in September 1984.¹¹⁹ The concerns of the manufacturers were assuaged by NTT's undertaking not to manufacture equipment for the "time being," which satisfied the manufacturers that NTT would not be competing with them for a long time.¹²⁰

As between the two ministries, MITI continued to show its concerns regarding the MPT's apparent victory in retaining control over the "liberalized" telecommunications industry, including data networks. The major area of conflict had to do with the terms of entry of foreign enterprises into competition with NTT, since MITI was under increasing pressure from the United States to ease any restrictions on the ability of American firms to enter the market. The ministries debated the definition of what would constitute a "foreign enterprise,"¹²¹ as well as whether companies seeking entry as VAN's would be subject to prior approval or would merely have to "register" with MPT.¹²² Ultimately,

¹¹⁶ *Id.* at 145.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.* Manufacturers came to believe that NTT would be so preoccupied with other aspects of the privatization process that it would be unwilling to immediately undertake the expenses associated with manufacturing activities. *See id.*

¹²¹ The original MPT definition was that 50% Japan ownership was required to qualify as "domestic," and that only such "domestic" firms would be permitted to enter into the common carrier business. The Americans opposed any such definition, seeking full access for foreign firms. *See id.* at 146.

¹²² *Id.* at 146-47. The Americans also had concerns about the imposition of equipment standards on firms seeking a license to provide VAN services. Prior to privatization, NTT was responsible for setting and adjudicating standards and the MPT originally proposed that after privatization a board should be established consisting of representatives of manufacturers. The Americans, with some support from MITI, argued that such a board would be inherently biased against foreign manufacturers and, after some argument, an independent board was established and standard specifications

a compromise was reached that allowed companies with 30% Japanese capital to provide the "basic voice" services which would compete directly with NTT and the MPT's licensing authority would be limited to the large-scale networking sector.¹²³ However, the Americans were still dissatisfied in that foreigners were to be precluded from owning any shares in NTT.¹²⁴

Within the LDP, the legislation had become part of the inter-party maneuvering surrounding the re-election of Prime Minister Nakasone to the leadership of the party.¹²⁵ Any failure to pass the telecommunications bills, which had become a vital part of Nakasone's efforts to privatize the nation's public corporations, could be seen as a serious blow to his reputation within the party. As such, it was not until after the leadership election at the end of December 1984 that the amended laws were finally passed, with the bills taking effect in April 1985.¹²⁶

3.3. *The Final Legislation*

The Telecommunications Business Law ("TBL")¹²⁷ transformed the regulatory structure governing the telecommunications industry in Japan by adopting the following elements:

1. Participants would be segregated into two major categories: Type I carriers, which would own and operate their own telecommunications facilities, and Type II carriers, which did not own their facilities but leased their circuits from Type I carriers in order to provide various "value added" services.¹²⁸ Type II carriers were further divided

were reduced in order to make it easier for foreign firms. *See id.* at 150-51.

¹²³ *Id.* at 147.

¹²⁴ *Id.* at 146.

¹²⁵ *Id.* at 145-46.

¹²⁶ *Id.* Article 1 of the Supplementary Provisions of the New NTT Law provided that its provisions would come into force "as from April 1, 1985." New NTT Law Supp. Prov. Art 1 in 2 COMMUNICATIONS STUDY GROUP, JAPANESE LEGISLATION OF TELECOMMUNICATIONS 1984.

¹²⁷ Telecommunications Business Law in 1 COMMUNICATIONS STUDY GROUP, JAPANESE LEGISLATION OF TELECOMMUNICATIONS (1987) (Unofficial translation). Article 1 of the TBL provides as follows:

The purpose of this Law is, considering the public nature of telecommunications business, by ensuring the proper and reasonable operation of such business, to secure the consistent provision of telecommunications service, to protect the interests of its users, and thereby to ensure both the sound development of telecommunications and the convenience of the people, and to promote the welfare of the public.

¹²⁸ Harris, *supra* note 43, at 17. Article 6 of the TBL provides as follows:

(1) Types of telecommunications business shall be categorized into Type I telecommunications business and Type II telecommunications business.

into "Special Type II" carriers, which offered large-scale network services (more than 500 circuits) nationally or internationally, and "General Type II" carriers, which offered size-limited network services.¹²⁹

2. Type I carriers could offer local exchange and/or interexchange services and, as mentioned above, could lease circuits to Type II carriers.¹³⁰ Type I carriers could also provide all of the services a Type II carrier was permitted to provide, including basic voice, data, facsimile, telex and VAN services.¹³¹ Type II carriers could not simply resell transmission or message services.¹³²

3. Type I carriers, including NTT, were subject to strict regulation by MPT. Entry required the prior approval of MPT; tariffs and changes in tariffs, including rates and other terms and conditions, required authorization by MPT;¹³³ and foreign ownership of Type I car-

(2) Type I telecommunications business shall be that business which provides telecommunications service by establishing telecommunications circuit facilities (which mean transmission line facilities connecting transmitting points with receiving points, switching facilities installed as inseparable units therefrom, and other facilities accessory to such facilities, the same shall apply hereinafter).

(3) Type II telecommunications business shall be any other telecommunications business than Type I telecommunications business.

¹²⁹ *Id.* Article 21 of the TBL provides as follows:

(1) Type II telecommunications business shall be classified into General Type II telecommunications business and Special Type II telecommunications business.

(2) General Type II telecommunications business shall be any other Type II telecommunications business than Special Type II telecommunications business.

(3) Special Type II telecommunications business shall be Type II telecommunications business which provides for the use of communications of many and unspecified persons telecommunications facilities which exceed in scale the standards stipulated, in terms of the capacity for accommodating telecommunications lines, in the applicable cabinet ordinance, or Type II telecommunications business which provides telecommunications facilities designed for communications between Japan and foreign points for the use of communications of others.

¹³⁰ *Id.* Inter-urban trunk routes with high profitability were expected to be the initial target of new entrants into the Type I carrier business. Such carriers will be able to take advantage of optical fiber, microwave and other new technologies and would rely on existing facilities, such as channels along the railway tracks, expressways and power transmission cables. In addition, it was anticipated that some carriers would use communications satellites to provide service due to the anticipated decreases in costs of hardware and launching, as well as the increased capacity of satellite transmissions. Shinto, *supra* note 43, at 381.

¹³¹ Harris, *supra* note 43, at 17.

¹³² *Id.*

¹³³ Article 9 of the TBL provides as follows:

(1) Any person who intends to operate Type I telecommunications business shall obtain permission therefor from the Minister of Posts and Telecommunications.

riers was limited to one-third,¹³⁴ except for NTT, in which foreign

(2) Any person who intends to obtain permission under the preceding paragraph shall, in accordance with the provisions of the applicable ordinance of the Ministry of Posts and Telecommunications, file with the Minister of Posts and Telecommunications an application which describes the following matters:

- i) Name and address of the applicant and in the case of a juridical person, name of the representative.
- ii) Category of telecommunications service according to the classifications stipulated in the applicable ordinance of the Ministry of Posts and Telecommunications, and provisioning descriptions of such service.
- iii) Service territory.
- iv) Outline of telecommunications facilities.

(3) A business plan and any other documents specified in the applicable ordinance of the Ministry of Posts and Telecommunications shall be attached to the application referred to in the preceding paragraph.

Article 10 of the TBL provides as follows:

The Minister of Posts and Telecommunications shall grant permission under the paragraph (1) of the preceding Article if he determines that an application for permission under the same paragraph conforms to each of the following items:

- i) Telecommunications service to be provided by the telecommunications carrier shall be appropriate in the light of the demand in the service territory.
- ii) The introduction of the telecommunications business shall not result in a significant excess of telecommunications circuit facilities to be used for such business in all or in any part of the territory or route to be covered by the telecommunications carrier.
- iii) The applicant shall have an adequate financial basis and technical capability to properly perform his or her telecommunications business.
- iv) The plan of the telecommunications business shall be reliable and feasible.
- v) In addition, the introduction of the telecommunications business shall be appropriate for the sound development of telecommunications in general.

¹³⁴ Article 11 of the TBL provides that the Minister of Posts and Telecommunications shall, regardless of the provisions of the preceding Articles, not grant permission under Article 9 paragraph (1) to those persons who fall under any of the following items:

- iv) Any person who does not have Japanese nationality.
- v) Any foreign government or its representative.
- vi) Any foreign juridical person or association.
- vii) Any juridical person or association which is represented by any person or body set forth in the preceding three items, or one third or more of whose officers are such persons, or one third of whose total voting rights is exceeded by the aggregate of voting rights directly held by such persons or bodies and voting rights calculated in accordance with the provisions of the applicable ordinance of the Ministry of Posts and Telecommunications, which is indirectly controlled by such persons or bodies through any other juridical person or association.

ownership was prohibited.¹³⁵ Special Type II carriers must register with MPT and notify MPT of their tariffs,¹³⁶ while General Type II carriers must simply notify MPT of their existence without the need to provide supplemental notification of tariffs.¹³⁷

¹³⁵ Harris, *supra* note 43, at 17. Article 4 of the New NTT Law provides as follows:

- (1) The shares of the Company shall be registered ones and may be possessed only by the Government, local public entities, Japanese nationals, or Japanese juridical persons half the number or more of whose members, shareholders or executive officers are not; or half of the amount or more of whose capital or contribution is not owned by; or the majority of whose voting rights do not belong to foreign nationals or foreign juridical persons.
- (2) The Government shall always hold one-third or more of the total number of the outstanding shares of the Company.
- (3) The Company shall obtain authorization from the Minister of Posts and Telecommunications in order to issue new shares. The same shall apply to the issuance of convertible debentures or debentures with preemptive rights to take new shares.

¹³⁶ Article 24 of the TBL provides as follows:

- (1) Any person who intends to operate Special Type II telecommunications business shall obtain registration from the Minister of Posts and Telecommunications.
- (2) Any person who intends to obtain registration under the preceding paragraph shall, in accordance with the provisions of the applicable ordinance of the Ministry of Posts and Telecommunications, file with the Ministry of Posts and Telecommunications an application which describes the following matters:
 - i) Name and address of the applicant and in the case of a juridical person, name of the representative.
 - ii) Category of telecommunications service according to the classification stipulated in the applicable ordinance of the Ministry of Posts and Telecommunications, and a provisioning description of such service.
 - iii) Outline of telecommunications facilities.
- (3) A business plan and any other documents specified in the applicable ordinance of the Ministry of Posts and Telecommunications shall be attached to the application referred to in the preceding paragraph.

¹³⁷ Harris, *supra* note 43, at 18. Article 22 of the TBL provides as follows:

- (1) Any person who intends to operate General Type II telecommunications business shall, in accordance with the provisions of the applicable ordinance of the Ministry of Posts and Telecommunications, submit a notification to that effect to the Minister of Posts and Telecommunications with documents which describe the following matters:
 - i) Name and address of the applicant and in the case of a juridical person, name of the representative.
 - ii) Category of telecommunications service according to the classification stipulated in the applicable ordinance of the Ministry of Posts and Telecommunications and a provisioning description of such service.
- (2) Any person who has submitted a notification referred to in the preceding paragraph (hereinafter referred to as a "General Type II telecommunications carrier") shall, where any of the matters specified in item 1) of

4. Since the proposed reforms to the telecommunications system in Japan were based on then-current projections of future growth areas, the Telecommunications Business Bill provided for a review within three years.¹³⁸

While the "new" NTT was ultimately to become a private corporation upon the sale of up to two-thirds of its shares to the public,¹³⁹ the MPT retained a good deal of discretion under the New NTT Law regarding operational and business matters of the firm,¹⁴⁰ including the following:

1. NTT was to retain its existing structure for at least five years, although the New NTT Law specifically provided for further review of the situation within five years after the date of incorporation of the new company (*i.e.*, by the end of March 1990).¹⁴¹

2. The MPT must authorize any issuance of new shares, including the issuance of debentures or convertible debentures with the preemptive right to subscribe for new shares.¹⁴² For its part, any decision to dispose of shares owned by the government must be within the limi-

the same paragraph has been changed, submit without delay a notification to that effect to the Minister of Posts and Telecommunications.

(3) A General Type II telecommunications carrier shall, before it changes any of the matters specified in paragraph (1) item (ii) above, submit a notification to that effect to the Minister of Posts and Telecommunications. This shall not apply, however, to such minor changes as specified in the applicable ordinance of the Ministry of Posts and Telecommunications.

¹³⁸ Article 2 of the Supplementary Provision to the TBL provides as follows: "The government shall, within three years from the date of the enforcement of this Law, review the situation under which this Law is executed and shall take necessary measures based upon the conclusion of the review."

¹³⁹ Item (2) of Article 4 of the New NTT Law provided that "The Government shall always hold one-third or more of the total number of the outstanding shares of the [Company]."

¹⁴⁰ Article 15 of the New NTT Law provides as follows:

(1) The Company shall be placed under supervision of the Minister of Posts and Telecommunications in accordance with the provisions of this Law.

(2) The Minister of Posts and Telecommunications may, if he determines it to be especially necessary in enforcing this Law, issue to the Company orders necessary for the supervision with respect to its business activities.

¹⁴¹ Article 2 of the Supplementary Provisions of the New NTT Law provided as follows:

The Government shall, within five years after the date of the incorporation of the Company, review the nature of the Company, taking into account the situation under which this Law is enforced and changes in circumstances after the enforcement of this Law, etc., and shall take necessary measures based upon the conclusion of the review.

¹⁴² New NTT Law Art. 4(3). Article 17 of the New NTT Law requires that the MPT consult with the MOF prior to taking any action under Item (3) of Article 4.

tation on the number of shares decided by the Diet in the relevant annual budget.¹⁴³

3. NTT would be free to invite subscription for new debentures, provided that the amount of debentures was not to exceed four times as much as the smaller amount of either the total sum of its capital and reserved fund or the existing net assets of the company as shown in its latest balance sheet.¹⁴⁴

4. The MPT must authorize the appointment or dismissal of executive officers and auditors of NTT,¹⁴⁵ as well as any attempt to change the articles of incorporation, dispose of profits, merge or dissolve the company¹⁴⁶ or transfer or mortgage its trunk lines or any other important telecommunications facilities.¹⁴⁷

5. NTT was to formulate a business plan for each fiscal year for submission to, and approval by, the MPT.¹⁴⁸ Also, NTT was to submit financial statements to the MPT within three months following the end of each fiscal year.¹⁴⁹

3.4. *NTT and Japanese Telecommunications After Deregulation*

After privatization and liberalization, NTT remained in a dominant market position, with the ability to provide both Type I and Type II services.¹⁵⁰ However, although NTT was technically a private com-

¹⁴³ New NTT Law Art. 5.

¹⁴⁴ New NTT Law Art. 7.

¹⁴⁵ New NTT Law Art. 9.

¹⁴⁶ New NTT Law Art. 10.

¹⁴⁷ New NTT Law Art. 13. Article 17 of the New NTT Law provides that the MPT must consult with the MOF before taking any action under Article 13.

¹⁴⁸ New NTT Law Art. 11. Article 17 of the New NTT Law provides that the MPT must consult with the MOF before taking any action under Article 11.

¹⁴⁹ New NTT Law Art. 12.

¹⁵⁰ Article 4 of the Supplementary Provisions to the TBL provides as follows:

(1) Any business which relates to the public telecommunications activities being actually conducted by Nippon Telegraph and Telephone Public Corporation before the dissolution (hereinafter referred to as "the Ex-Corporation") at the time of enforcement of this Law and falls or is deemed to fall under Type I telecommunications business shall be deemed to be the business of which Nippon Telegraph and Telephone Corporation (hereinafter referred to as "NTT") has obtained permission under Article 9 paragraph (1) on the day of enforcement of this Law (hereinafter referred to as "the enforcement day").

(2) Any business which relates to the public telecommunications activities being actually conducted by Kikusai Denshin Denwa Company, Ltd. (hereinafter referred to as "KDD") at the time of enforcement of this Law and falls or is deemed to fall under Type I telecommunications business shall be deemed to be the business of which KDD has obtained permission under Article 9 paragraph (1) on the enforcement day.

(3) Both NTT and KDD shall, within one month of the enforcement day,

pany, it was still obligated to supply universal and equitable service as if it were a public monopoly¹⁵¹ and, as such, NTT was required to cross-subsidize "deficit" services as a public utility if MPT set tariffs below the level of costs for such services.¹⁵² NTT was also required to continue to promote its basic research activities in telecommunications technology and to insure that the results thereof were circulated in a manner which promoted the "interests" of the public.¹⁵³

A most significant, and somewhat controversial, element of the TBL was the discretion granted MPT with respect to authorizing the level of competition among NTT and new Type I carriers.¹⁵⁴ As it

submit a notification on the matters specified in the applicable ordinance of the Ministry of Posts and Telecommunications with respect to the business stipulated in the preceding two paragraphs to the Minister of Posts and Telecommunications.

¹⁵¹ HILLS, *supra* note 74, at 147. Article 2 of the New NTT Law provides as follows:

The Company shall, in managing its business referred to in the preceding Article, give consideration to the maintenance of its proper and efficient management and shall contribute to the securement of provision of stable nationwide telephone services throughout Japan by providing such services indispensable to the people's life at appropriate conditions and impartially. In addition, the Company shall endeavor, in view of the importance of the role which telecommunications will play in the future progress of society and economy, to contribute to the creative advancement and development of telecommunications in Japan through promoting its basic research and development activities in telecommunications technology and through disseminating the results thereof, and thereby to promote the interests of the public.

¹⁵² Nambu, *supra* note 53, at 150-1. The legislation actually provided that 10 yen would remain the unit for pricing, meaning that while NTT could possibly alter the time and distance allowed for the unit price, it could not increase the local telephone call tariffs. HILLS, *supra* note 74, at 147. Therefore, NTT would not be able to protect its revenue from local services by increasing costs of local calls significantly. *Id.* The introduction of competition in the long-distance market may ultimately make it very difficult for NTT to continue to cross-subsidize local services, particularly if competitors are permitted to charge lower rates than NTT and NTT is not allowed to adopt "cost-based" pricing for its services. Commentators have noted that NTT's revenue structure is inherently unstable, since about 30% of its revenues from telephone calls in the late 1980's came from just three percent (3%) of its total subscribers. *Id.* at 156.

¹⁵³ New NTT Law Art. 2.

¹⁵⁴ The regulations are similar to the kind often applied to the public utilities. One is the "demand and supply adjustment clause," by which the MPT can regulate the rate of entry to avoid purportedly ruinous competition. The rate level and rate structure of telecommunications services are subject to MPT regulation based on traditional rate-of-return principles. According to the new tariff accounting rule, all rates of services must be based on the fully distributed cost. Fair rate of return is to be calculated based on the average rate of return of the major industrial sector. Nambu, *supra* note 53, at 150. Clearly, MPT was a major "winner" from the deregulation of NTT. According to one source, the MPT "gained such wind-fall power over telecommunications as it never dreamed of . . ." HILLS, *supra* note 74, at 152.

turned out, MPT was willing to authorize several new entrants,¹⁵⁵ including three firms, sometimes referred to as the "New Common Carriers," or "NCCs," Japan Telecom Company, Teleway Japan Corporation and Daini-Denden Inc.,¹⁵⁶ which began supplying private-line services in the large and profitable Tokyo-Osaka market in 1986 and followed with public telephone services in 1987.¹⁵⁷ Another firm, Tokyo Telecommunications Network, provided local services in the Kanto District,¹⁵⁸ and several other firms were established to provide regional leased services and satellite communications.¹⁵⁹

Literally hundreds of firms entered the rapidly growing Type II services markets, offering a wide range of services and business applications.¹⁶⁰ Special Type II carriers, of which there were 17 by July 1988,

¹⁵⁵ A list of the new Type I carriers, as of July 1988, appears in Harris, *supra* note 43, at 24.

¹⁵⁶ As Harris explained:

Daini Denden . . . hoped to be the "second telephone company" (the English translation of its company name) . . . [however] other would-be entrants eagerly sought authorization as well, including Japan Telecom and Teleway Japan. *Keidanren* expended considerable effort to arrange a "consolidation" of these entrants into a single competitor to NTT, on the grounds that one company could offer stronger competition than several. The political [and financial] backing of the several entrants would not be denied and each began to offer Type I services over an area that encompasses a majority of the Japanese population. The origins of these new common carriers (NCCs) is illustrative of the Japanese style of collective business organization. An initiative of the Public Highway Corporation, Teleway Japan is owned by Toyota, Mitsubishi Corp., Mitsui & Co. and Sumitomo Corp., among others. It has an optical cable network laid along the highways linking Tokyo, Nagoya and Osaka. Japan Telecom was organized by JNR, but also has nearly 300 corporations as its owners. While not contractually required, it is expected that the corporate owners of each of the NCCs will purchase some services from that carrier.

Harris, *supra* note 43, at 18-19.

¹⁵⁷ Nambu, *supra* note 53, at 50.

¹⁵⁸ The Tokyo Telecommunications Network is a subsidiary of the electric utility monopoly in the Kanto District (the Tokyo Denryoku Corporation). *Id.* at 150.

¹⁵⁹ A number of domestic and foreign organizations gave consideration to competing with NTT through the use of satellite transmissions. The concept created further tensions between the United States, which had a technical advantage and brought some degree of pressure to bear upon Japan to reduce the balance of payments deficit between the two countries by purchasing any new satellites from the United States, and the MPT, which had a policy of delaying the further use of communications satellites until the launch of a Japanese satellite in 1990. Ultimately, Japan agreed to allow NTT's private competitors to purchase satellites from the United States and three new ventures were formed to provide new services utilizing satellites. However, serious doubts existed as to whether or not one, let alone three, satellite competitors could provide services in Japan on a cost-effective basis. HILLS, *supra* note 74, at 148-50.

¹⁶⁰ MPT estimated that the market for Type II services was almost \$3.4 billion. Nambu, *supra* note 53, at 151. Information regarding the characteristics of the 452 new General Type II carriers (as of July 1988), including the location of their main offices, type of business previously engaged in, types of services and business applica-

included IBM, AT&T and most of the leading computer and communications firms in Japan.¹⁶¹ In fact, one of the major players in the VAN market was Nippon Information and Communications Corporation, a joint venture between NTT and IBM.¹⁶² NTT's agreement to enter the VAN market with IBM using NTT's data network and IBM's computers was vigorously opposed by the two largest equipment manufacturers in Japan, Fujitsu and Hitachi, since the proposed VAN allowed IBM to use NTT's local offices to sell its hardware. Although competitors argued that such a relationship would not be permitted under American antitrust laws, the MPT did not oppose the proposal, noting that to do so would only exacerbate trade tensions with the United States.

In addition to the aforementioned changes in the telecommunications area a number of interesting developments occurred with respect to cable television ("CATV"), particularly since the MPT approved the limited operation of two-way cable systems in May 1984. However, although a number of companies have undertaken construction of CATV services, their profitability has yet to be proven. Construction of facilities has been expensive due to the high cost of land and complicated regulations may further increase the costs. Moreover, a good deal of uncertainty exists as to whether or not consumers will be willing to pay the extra money for cable services.¹⁶³

As competition grew in the basic telecommunications area, NTT responded by aggressively moving into a number of related business areas,¹⁶⁴ as well as by making significant investments designed to up-

tions, appears in Harris, *supra* note 43, at 27-28. The "typical" General Type II carrier was located in Tokyo or Osaka, was previously engaged in information communication processing, offered data and/or voice transmission and focuses on transmission and exchange of order data between retailers and wholesalers. Other significant applications included voice mail and electric mail. "As of . . . October [1989], more than 780 companies had entered the Type II telecom business. Of the total, 27 were special Type II telecom businesses." Makiura, *Unanswered Questions*, 1 J. JAPANESE TRADE & INDUS., 28 (1990). It was anticipated that the annual growth rate of the market for Type I businesses from 1988 to 1992 was 7.3% while the market for information services increased 21.5% and VAN increased 23.1%. During that same period, the market for CATV increased 72.9%. Hasegawa, *Satellite Age*, 1 J. JAPANESE TRADE & INDUS. 29 (1990).

¹⁶¹ For a list of the 17 Special Type II carriers (as of July 1988), including location, types of services offered (e.g., voice, video, data or integrated) and service area, see Harris, *supra* note 43, at 25-6.

¹⁶² *Id.* at 19-20; HILLS, *supra* note 74, at 151.

¹⁶³ See Toshio, *supra* note 71, at 386-87, for a brief summary of the evolution of the CATV service industry in Japan.

¹⁶⁴ As of July 1988, NTT had created nearly 100 new subsidiaries or affiliated companies and joint ventures since its privatization, including many lines of business from which the RBOCs in the United States would be restricted. Among the operations to be conducted by the subsidiaries were design of data communications systems; basic

grade its infrastructure and fully digitize its network.¹⁶⁵ "While not directly engaged in equipment manufacturing, NTT has aggressively expanded its equipment research, development and design activities."¹⁶⁶ Moreover, NTT's pursuit of the ISN concept resulted in the introduction of basic service on a commercial basis in April 1988, with primary service to follow during the next year, and it is anticipated that pricing of ISN services will provide substantial savings over existing services, especially at long distances.¹⁶⁷

The early results on the competitive effect of deregulation are somewhat mixed. For their part, the NCCs have been able to achieve very rapid growth due, in part, to the MPT's tariff and access policies, which maintained a sizable difference between the rates allowed for NTT and the NCCs.¹⁶⁸ In fact, all three of the NCCs posted net profits in the FY ended March 31, 1990.¹⁶⁹ However, despite NTT's claims that the MPT's policies are impairing its ability to attract new business,¹⁷⁰ NTT retains an overwhelming portion of the market share for Type I services and, in the FY ended March 31, 1990, recorded sales nearly sixty times greater than the largest of the NCCs.¹⁷¹

As for Type II services, the financial and technical strengths of

software development; sales of PC application systems; overseas engineering, sales, installation, operations and consultation; design and operation of VAN systems (joint venture with IBM); telemarketing; real estate; credit card services; overseas financing; leasing of terminal equipment; leasing of cars and trucks and health promotion activities. In 1985, NTT entered into an agreement with AT&T to exchange product development, marketing and management know-how. *Id.* The intention of the parties was to develop a new generation of digital switching and a standardized computer protocol for linking incompatible computers. HILLS, *supra* note 74, at 151. For a list of NTT's newly-established affiliations as of July 1988, including the amount of capitalization and description of operations, see Harris, *supra* note 43, at 29-31.

¹⁶⁵ Harris, *supra* note 43, at 20.

¹⁶⁶ *Id.* It should come as little surprise that NTT's massive procurement needs for telephone equipment have led to allegations that the company abuses its position to obtain favorable prices when purchasing from manufacturers. Nambu, *supra* note 53, at 151.

¹⁶⁷ Harris, *supra* note 43, at 20.

¹⁶⁸ *Id.* at 19. In related matters, NTT's pricing flexibility was further impaired by its inability to lower its long distance rates or raise its local rates. *Id.*

¹⁶⁹ JEI REPORT NO. 32A, *supra* note 5, at 4. Now that the Type I carriers have recovered their cumulative losses, it is anticipated that the thrust of competition against NTT will shift from conventional price-cutting wars to contests for more diversified services. Makiura, *supra* note 160, at 28. While Tokyo Telecommunication Network Inc. has experienced markedly expanded sales, all regional MTCs, including Tokyo Telecommunication Network, have suffered considerable losses and continue to face difficult times in the future. *Id.* Two international MTCs, called second KDDs, showed rapid growth following their startup in October 1989, and hold a combined market share of 30% as of the beginning of 1991. In response, KDD reduced its prices and that set off a year of intense price competition. *Id.*

¹⁷⁰ Harris, *supra* note 43, at 19.

¹⁷¹ JEI REPORT NO. 32A, *supra* note 5, at 4.

Japanese electronics companies, as well as foreign firms such as IBM, have resulted in significant competition for NTT, in spite of its inherent advantages.¹⁷² MPT has assisted the efforts of the competitors through its open-information policy for format and interface standards.¹⁷³ Predictably, however, deregulation and competition in this area have spawned trade tensions between the United States and Japan, leading to tense, and seemingly continuous, negotiations regarding the ability of foreign participants to operate in Japan's domestic market and in competition with KDD.¹⁷⁴

From a financial perspective, NTT's performance since deregulation reflects some of the displacement of the reorganization process. Operating revenues rose by over five percent (5%) annually in each of FY 1986 and FY 1987; however, during the next two years growth slowed to three percent (3%).¹⁷⁵ Operating expenses increased significantly during the same period,¹⁷⁶ leading to fluctuations in operating income and a disappointing FY 1989 performance during which operating income actually fell below the comparable figure for FY 1985.¹⁷⁷ Nonoperating performance actually improved over the period, yet remains a small part of NTT's total picture,¹⁷⁸ and the company's ability to manage its tax obligations resulted in fairly steady growth in net income

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ For example, negotiations which finally ended in August 1990 resulted in some form of agreement as to steps that would be taken by the Japanese in order to improve the competitive position of foreign suppliers of "network channel terminating equipment," including access to NTT's technical specifications on an equal footing with Japanese suppliers. Also, the approval process for foreign firms interested in operating VAN's was to be shortened from several months to a maximum of 30 days and foreign VAN operators would be allowed to provide enhanced services from Japan to the United States and other points overseas. Finally, KDD was called upon to eliminate its surcharges of up to 20% which it had levied on foreign VAN companies that leased international lines. JAPANESE ECONOMIC INSTITUTE. REPORT NO. 31B at 9-10 (1990). Regarding various other issues surrounding attempts by foreign firms to enter the Japanese telecommunications market following deregulation activities in 1985, see 6 *Japan Lawletter* Issue 1 (1987) at 38-41. Among the topics covered are joint ventures by United States firms to enter the Type I carrier market, the mobile telephone market and NTT procurement policies.

¹⁷⁵ JEI REPORT NO. 32A, *supra* note 5, at 4-5. Telephone revenues accounted for 84% of all operating revenues in FY 1985 and for 79% of all operating revenues in FY 1988. *Id.* at 5.

¹⁷⁶ *Id.* at 4-5. Operating revenues increased by 18% from FY 1985 to FY 1989, while operating expenses jumped by over 23% during the same period. *Id.* at 5.

¹⁷⁷ *Id.* at 4-5. Operating income for FY 1985 was 757 billion yen, while operating income for FY 1989 was 705 billion yen. Operating income had peaked at 914 billion yen for FY 1987. *Id.* at 5.

¹⁷⁸ *Id.* at 5-6. Losses from nonoperational activities dropped from 384 billion yen in FY 1985 to 195 billion yen in FY 1989. However, nonoperating revenues still only accounted for just over one percent (1%) of the firm's total revenues. *Id.* at 5.

after taxes.¹⁷⁹ While NTT's assets have not grown significantly, management did succeed in reducing the firm's long-term debt and increasing shareholder's equity.¹⁸⁰

3.5. *Operational Future for NTT and the Industry*

The New NTT Law called for an examination of the desirable status of the company, and the implementation of any supplemental measures necessary to combat any perceived problems, by March 1990.¹⁸¹ While it appeared that significant progress had been made in permitting new competitors to enter the market for telecommunications services, particularly in the Type II services area, NTT's continued dominance in the marketplace had remained a concern for various constituencies, as had management's inability to hold down the level of expenses and improve services.¹⁸² Also, as noted below, NTT's privatization program had gone from boom to bust, creating a significant breach of confidence in the ability of the government and NTT executives to manage the newly-privatized entity. As such, analysts awaited with great anticipation the recommendations of powerful interest groups, and the actions of the LDP itself, with respect to the medium-term structure of NTT.

In February 1990, the *Keidanren's* Committee on Information Telecommunications Policy announced its view that NTT ought to take further steps to insure competition and to increase efficiency and that regulations pertaining to the telecommunications business generally needed to be further reduced.¹⁸³ Specifically, the Committee felt that fair competition would be significantly enhanced by the breakup of NTT into local network operating bodies and other operations.¹⁸⁴ However, it was conceded that there was not sufficient managerial and technological information available in order to assess the consequences of such an action and it concluded that any judgment on whether to reorganize NTT ought to be delayed until such information was available.¹⁸⁵ As such, the Committee recommended that detailed and specific

¹⁷⁹ *Id.* at 5-6. Net income after taxes rose steadily from FY 1985 (185 billion yen) to FY 1989 (274 billion yen). *Id.* at 5.

¹⁸⁰ *Id.* at 5-6. The firm's asset value remained essentially unchanged during the period from FY 1985 through FY 1989. Shareholders' equity increased by approximately 14% during the period. *Id.* at 5.

¹⁸¹ New NTT Law Supp. Prov. Art. 2.

¹⁸² JEI REPORT NO. 32A, *supra* note 5, at 6.

¹⁸³ Watanabe, *NTT and Japan Telecommunications System*, 121 *Keidanren Rev.* 8, 9 (February 1990).

¹⁸⁴ *Id.* at 8.

¹⁸⁵ *Id.*

studies be undertaken on the digitalization of networks, research and development, charges for local calls, rights of shareholders and other matters.¹⁸⁶

Until the requisite studies could be completed, the Committee recommended that NTT take the following measures to enhance fair competition and increase management efficiency:

[F]irst, the monopolistic local networks division and the other competitive divisions should be clearly separated as internal organizations. Secondly, the accounting system should be divided so that revenues and expenditures may be clearly represented by type of services. Thirdly, the terms and conditions of trade within NTT and those between NTT and other telecommunications companies should be equalized. In addition, information pertaining to competitive operators should be managed properly so as to prevent its internal misuse. Aside from these internal measures, it is also necessary for NTT to build open networks, disclose corporate information and establish a nationwide digital network at an early date.¹⁸⁷

In summary, the *Keidanren*'s constituencies remained dedicated to reducing the competitive advantages which they felt accrued to NTT due to its size and apparent ability to subsidize new activities with revenues from its monopoly-type services. It was acknowledged that little or no work had been done on analyzing the effect of an "AT&T-type" break-up. In the interim, NTT was called upon to undertake a voluntary separation of certain of its activities and to facilitate the analysis of its relationships by enhanced disclosure of financial and operational information. On the other hand, as the issue of break-up was considered, NTT was to continue to pursue its "universal" service objectives.

In addition to the measures to be taken by NTT, the Committee made additional recommendations regarding the overall process of deregulation of the telecommunications business, including the following:

1. The scope of governmental approval required for services to be provided by Type I carriers such as NTT and new long-distance carriers should be reduced.¹⁸⁸ For example, the Committee recommended that approval be "confined to services having a close bearing on national life, such as pure telephone service. In addition, the operating guidelines for the supply-demand adjustment clause in each field of ac-

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* at 9.

¹⁸⁸ *Id.*

tivity should be publicly disclosed"¹⁸⁹ and eased in parallel to private competition.¹⁹⁰

2. Type I carriers "should try to introduce a rational charge system and allow voice connections from the public network to the private circuits and then back to the public network in order to promote liberalization in the use of circuits and improve the charge systems. In addition, each carrier should make further efforts to introduce a discount system for large users and expand the scope of nighttime and midnight discounts."¹⁹¹

3. The provisions in the existing laws that prohibit foreign stock ownership as well as the clause in the new NTT Law obligating the government to hold one-third of NTT stock, should be reexamined."¹⁹²

Keidanren's recommendations focused on enhanced competition and reduced rates for large users, both of which could be expected to benefit its members. Taking into account the Committee's recommendations, the LDP proposed a revision to the NTT law in March 1990 which called for the following:

1. Internally dividing NTT's business into "long-distance and regional communications operations and insuring complete disclosure of information on revenues and expenditures,
2. Preparing disclosure and implementing a thorough rationalization program [by NTT] on a voluntary basis,
3. Considering recycling earnings to shareholders in the form of larger dividends,¹⁹³
4. Carrying out the necessary deregulation measures, and
5. Conducting study of the desirable structure of NTT, based on the above results, and in fiscal 1995 reaching a conclusion based on that study."¹⁹⁴

Given an additional five years by the LDP to address outstanding concerns over NTT services, as well as to restore the public's confidence in the company and its shares, NTT can be expected to undertake a number of programs designed to improve its co-local and long-distance telephone businesses as well as the following additional

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ Increasing the dividend payout presumably would increase the attractiveness of the NTT shares as an investment vehicle and restore the public confidence in NTT and the Government's ability to insure that NTT shares were a safe investment for individual shareholders.[Footnote added.]

¹⁹⁴ Makiura, *supra* note 160, at 28.

opportunities.¹⁹⁵

1. NTT can be expected to move forward rapidly with its plans to provide INS. It is expected that the size of the information industry will quadruple between 1986 and 2005 leading to an increase from 85.3 billion yen to 333.3 billion yen during that period.¹⁹⁶ "Digital electronic media also are predicted to expand their share of the market. Telecommunications and data processing will account for 70% of the industry's income, up from the current 50%."¹⁹⁷ NTT anticipates that it will be able to use "sophisticated image processing services to convey high-definition images, high resolution text and graphics and, eventually three-dimensional images to individual users. . . [and] users will be free to personalize their communications services, picking from a wide range of options and tailoring them to meet individual preferences."¹⁹⁸

2. In order to implement its vision for INS, NTT is anticipated to continue its strong commitment to research and development spending. In fiscal year 1988, research and development expenditures jumped 22% to about \$1.5 billion.¹⁹⁹ Fiscal year 1990 projections for research and development were over \$1.6 billion.²⁰⁰ In addition to this applied research, NTT will continue its basic research in order to accede to the government's demands for more basic research as well as to provide NTT with "entree to non-telecommunications fields, such as computer software and medical/diagnostic equipment."²⁰¹

3. NTT is anticipated to continue its policies of broadening its scope of services by establishing and funding specialized subsidiaries outside of its core businesses. In addition, it will continue to establish affiliated firms related to its core businesses of telecommunications consulting, terminal equipment sales and information services.²⁰²

As of this writing, the operational future of NTT is somewhat hazy. Realizing that significant pressure is building to further deregulate the industry during the current decade, NTT decisionmakers appear to be embarking on a dynamic and costly program of basic and applied research designed to provide it with some form of competitive advantage by virtue of its INS product offerings. While real concern does exist about the price level of NTT shares, it is unlikely that im-

¹⁹⁵ JEI REPORT NO. 32A, *supra* note 5, at 7.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 8.

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *Id.*

provements in shareholder confidence will be a material objective, other than as part of a broader effort on the part of the government to calm investor fears in light of recent downturns in the Japanese securities markets and disclosures of activity which can only be called "self-dealing," without regard to its legality under Japanese laws.

3.6. *International Telecommunications Services*

NTT was not the only public corporation in Japan affected by the call for deregulation in 1985. As noted above, until 1985 international telecommunications services in Japan were provided by KDD, a monopoly "special private" corporation in which private investors had held a majority stake since its founding in 1953.²⁰³ Although KDD was certainly more "private" than NTT, the MPT has retained a good deal of discretion regarding KDD's activities by virtue of its status as the largest shareholder, almost 11%, and its ability to authorize KDD's operating plans.²⁰⁴ In the mid-1980's, the market for international telecommunications was less than one-twentieth the size of the domestic market; however, deregulation was expected to bring with it competition for KDD.²⁰⁵

Under the TBL, both NTT and KDD were authorized to continue their existing activities and were each designated as Type I carriers with respect to their scope of business.²⁰⁶ While NTT could enter the international market after deregulation, it was anticipated that the major competition to KDD would come through the Special Type II carriers. However, KDD still feared that NTT might enter the international market itself or agree to lease international lines to new Special Type II carriers. As such, KDD concluded that it had best enter the VAN business itself, thereby giving it a product to offer to the end user.²⁰⁷

Two companies, International Telecom Japan Inc. and International Digital Communications Inc.,²⁰⁸ set out to challenge KDD and

²⁰³ *Id.* The enacting legislation for KDD was the Kokusai Denshin Denwa Company, Ltd. Law (Law No. 301 of 1952, as amended) (the "KDD Law"), which was amended at the time of deregulation by Law No. 87 of 1984.

²⁰⁴ *Id.*

²⁰⁵ Nambu, *supra* note 53, at 151-52.

²⁰⁶ TBL Supp. Prov. Art. 4.

²⁰⁷ HILLS, *supra* note 74, at 147-48. Although Article 1 of the KDD Law makes it clear that the purpose of KDD is to supply international telecommunications services, Article 2 of the KDD Law contemplates that KDD may enter into such other business activities as may be incidental to its purpose.

²⁰⁸ JEI REPORT NO. 32A, *supra* note 5, at 8. No foreign-owned competitors have entered the field against KDD; however, International Digital Communications Inc. is backed by Britain's Cable & Wireless Plc and Pacific Telesis International Inc. from

"have provided leased circuit [and telephone] services to neighboring Asian countries since . . . 1989."²⁰⁹ Although the competitors are running significant deficits, particularly in light of the large start-up costs, it is believed that they will be able to turn a profit in a few years.²¹⁰ However, "KDD probably will continue to dominate the market even though MPT's regulations call for KDD rates to be about 23% higher than those of its rivals."²¹¹ From a financial perspective, KDD has had some difficulties with increasing operating costs,²¹² although its overall balance sheet outlook remains solid and the value of shareholders' equity has steadily improved.²¹³

In light of the fact that KDD operates in a relatively narrow market and because certain international telecommunications organizations require that one organization be appointed as the national representative of the country, it is unlikely that any attempt will be made to break-up KDD or its special relationship with the MPT relating to international telecommunications issues.²¹⁴ In the future, KDD will attempt to improve its core operations, by adding new services, improving existing services and developing and introducing new forms of technology,²¹⁵ and diversify into new forms of businesses which support its activities in telecommunications and information processing technologies.²¹⁶

the United States, as well as by Toyota and C. Itoh & Co. *Id.*

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.* Although MPT's regulations called for KDD rates which were about 23% higher than those charged by competitors, the MPT has allowed KDD to reduce its rates under certain circumstances. *Id.*

²¹² *Id.* at 9-10. "KDD's net profits fluctuated even though its operating revenues grew steadily, at least until FY 1989. . . KDD's management cited sharply rising costs for marketing, customer service, equipment and research," particularly in FY 1989. *Id.* at 9.

²¹³ *Id.* at 9, 10.

²¹⁴ *Id.* at 9. "For example, Intelsat, Inmarsat and the International Telecommunications Union." *Id.*

²¹⁵ *Id.* at 9, 11. For example, KDD will attempt to provide easier billing and payment methods in order to keep existing corporate and individual customers. Also, KDD will offer various packaged services for its corporate customers and expend additional amounts on new undersea fiber-optic cables to improve the quality and availability of its services. With respect to new technologies, KDD is developing international video conferencing, improved satellite systems and computerized network management systems. *Id.*

²¹⁶ *Id.* at 11. "New ventures include Kokusai Information Service Co., Ltd., which markets Japanese and foreign data base services; OSI Plus Corp., which develops software based on the Open Systems Interconnect standard; and KDD Technology Corp., which seeks to spin off other products and services from KDD's telecommunications and information processing technologies." *Id.* at 11. Other subsidiaries conduct marine surveys for submarine cables and other projects and manage and develop KDD's real estate assets. *Id.*

4. PRIVATIZATION AND DEREGULATION OF AIRLINES, RAILWAYS, AND TOBACCO

While deregulation of NTT and the subsequent offering of its securities in the Japanese securities markets had the biggest impact on everyday life and upon Japan's capital markets, Nakasone's original plans also contemplated sweeping changes for at least three other major public corporations by 1987. While the state-controlled airlines, railways, salt and tobacco companies did not, at least directly, have the same sort of impact on government finances as the NTT offerings, the apparent attempt to privatize the debt built up by these entities, as well as corresponding deregulation designed to insure that the industry sectors achieved some minimal form of competitiveness, is worth noting.

4.1. Airlines

Air transport policies in Japan, as in many countries, evidence the tension between competitive efficiencies and national security and sovereignty interests. Historically, air transport in Japan has been heavily regulated; "scheduled airline services require[d] licenses and fare changes [were] subject to prior approval by authorities."²¹⁷ The growth of domestic demand for air transport was relatively modest during the early 1980s, at least in comparison to the United States and the United Kingdom.²¹⁸ However, as deregulation in the United States increased competitive pressures in international air services and impending unification in the EC led to the creation of larger continental carriers in the aftermath of mergers between domestic airlines in the EC, Japan recognized the need for reform in its own system.

Until 1985, air transport in Japan was dominated by three major domestic carriers, each of which serviced a different role in an administratively-ordained system of market segmentation. JAL was the sole scheduled international carrier and also was assigned domestic trunk routes.²¹⁹ All Nippon Airways ("ANA"), a private firm, handled domestic flights and international charters and Japan Air System ("JAS") (formerly known as Towa Domestic Airlines) mainly operated

²¹⁷ *OECD Japan 1987/88*, *supra* note 21, at 83.

²¹⁸ *Id.* Domestic demand for air transport increased 11 per cent between 1980 and 1985 compared with 24 per cent in the United States and 25 per cent in the United Kingdom. "The limitation of airport facilities, the availability of high-speed trains and high air fares explain the limited demand. While unrestricted air fares were not very different from comparable fares in most other countries . . . discount tickets are less widely available" than in the United States. *Id.*

²¹⁹ *Id.* at 84.

local routes.²²⁰ Severe restrictions made entry into the market by new competitors very difficult and applications for licenses would be changed if the prospective additional supply would execute existing demand.²²¹ Moreover, the then-existing structure effectively insulated JAL from serious competition from ANA and JAS in the lucrative international cargo area.²²²

In May 1985, Japan and the United States reached agreement on a series of amendments to their 1952 bilateral civil aviation accord.²²³ The amendments broke JAL's monopoly on international cargo services by giving trans-Pacific rights to Nippon Cargo Airlines, allowed ANA and JAS to gain scheduled international passenger service and increased the number of foreign competitors in all segments of Japan's domestic passenger and cargo markets.²²⁴ Moreover, pursuant to recommendations made in the Report of the Transport Policy Council to the MOT in June 1986 (the "Transport Policy Council Report"), competition in the domestic market was encouraged by opening up domestic routes to additional companies.²²⁵

The Transport Policy Council Report included a recommendation that the government divest itself of its remaining shares in JAL.²²⁶ In September 1987, the Diet voted to abolish the Japan Air Lines Co.

²²⁰ *Id.*

²²¹ *Id.*

²²² JEI REPORT NO 32A, *supra* note 5, at 11. "International passenger competition between JAL and the two domestic carriers was limited to unscheduled charter flights to a handful of foreign countries and domestic segments of JAL's international routes. In addition, cargo carriers were restricted to domestic service." *Id.*

²²³ *Id.* at 11, 12.

²²⁴ *Id.* at 12.

²²⁵ OECD *Japan 1987/88*, *supra* note 21, at 84. However, OECD criticized the Japanese policies as falling short of comparable developments in the United States and United Kingdom, noting that:

The Report of the Transport Policy Council indicates that Japanese deregulation for airlines essentially aims at flexible administrative guidance. In particular, both entry and pricing remain administratively controlled by the government. Also market segmentation remains virtually intact, with JAL still serving almost all international routes and ANA most domestic routes. Allowing an additional company to serve a route while maintaining price controls merely replaces a monopoly with a duopoly (or with an oligopoly) where competition on price is excluded by regulation, as is the case for most intra-European routes. In the authorities' view, free competition in airlines is not appropriate in Japan because of the shortage of air traffic capacities in Tokyo and Osaka, because of concern to maintain the highest safety standards, and because of the objective of maintaining a nation-wide network. Nevertheless, lower prices would stimulate demand considerably. Better use of the 80 per cent of airports that face few, if any, capacity constraints would allow bottlenecks to be avoided.

Id.

²²⁶ *Id.*

Law, which was otherwise scheduled to expire in November 1988, and sold the remainder of its JAL shares, which amounted to a 34.5% interest in the company, for \$4.4 billion in November 1987.²²⁷ While JAL was given complete control over its internal structure, it must still submit its annual operating plan to the MOT for review and approval.²²⁸

In Japan, entry, exit, transportation charges and similar matters relating to the airlines industry are regulated through a variety of licensing, notification and authorization requirements. For example, airlines must apply for a license for each separate route and the application will be reviewed in light of the appropriateness of the airline for the route, its ability to service the route and handle the additional volume of business and overall supply and demand conditions.²²⁹ A temporary lapse of service on a route requires permission from the authorities, but a route may be permanently abandoned simply by affording advance notice to the authorities.²³⁰ Fares, including discounts, must be authorized and will be reviewed in light of the fair level of return and the need to limit discriminatory pricing practices.²³¹

There was little doubt that JAL would remain a formidable competitor following deregulation. It had a large fleet of planes, a well-established network of overseas offices and, not unimportantly, access to the domestic routes formerly reserved to ANA and JAS.²³² However, competition has also increased significantly since 1985,²³³ and the airline has been attempting to deal with a variety of problems, including labor issues,²³⁴ management divisions and inflight-

²²⁷ JEI REPORT NO. 32A, *supra* note 5, at 12.

²²⁸ *Id.*

²²⁹ Uekusa, *supra* note 1, at 257. License applications must be accompanied by a business plan which sets forth such things as the total number of aircraft, number of flights and departure and arrival times. Any modifications to the plan must be authorized in advance. *Id.*

²³⁰ *Id.*

²³¹ *Id.*

²³² JEI REPORT NO. 32A, *supra* note 5, at 12.

²³³ *Id.*

The level of competition in domestic and international service has increased sharply since 1985. JAL now goes head-to-head with ANA and JAS on most domestic routes. JAS returns the compliment to many Asian destinations, and ANA is building its routes to the United States and Europe. At least seven American companies battle JAL for the booming transpacific passenger and cargo business; numerous other foreign carriers vie for rights to serve Japan.

Id.

²³⁴ *Id.*

Outsiders criticize JAL for having too many people in management and administration, and not enough pilots, flight attendants and ground crews.

ing²³⁵ and public concerns regarding safety that arose after the crash of a jumbo jet on a domestic flight in 1985.²³⁶

A boom in overseas tourism, generated by the growing affluence of the Japanese citizenry and programs devoted to increasing consumer spending, as well as a strong volume of cargo business from export and import trade, has allowed JAL to recover from losses suffered in FY 1985 and FY 1986 because of depressed passenger levels.²³⁷ Operating revenues rose 13.3% in FY 1989 to just under \$7.1 billion,²³⁸ although profits decreased 4.4% to \$10.5 million.²³⁹ The dip in profitability reflects increases in the relative level of sales and advertising expenditures,²⁴⁰ as well as the funding of new equipment, both of which occurred following privatization.²⁴¹ JAL has also increased its financial investments after the 1987 divestiture, a strategy designed to maximize return on its financial assets.²⁴²

Foreigners make up an important part of JAL's flight crews, particularly as pilots. JAL is responding with improved training programs but service expansion is likely to outpace the supply of pilots for some time.

Id.

²³⁵ *Id.* at 14.

At headquarters JAL has tried to reshuffle management to end internal divisions and infighting. During JAL's long and intimate relationship with the government, factions mirroring various bureaucratic interests within the Ministry of Transportation developed and came into conflict with groups representing other interests. A June 1989 reorganization of the board of directors and subsequent personnel shifts, targeted at reducing MOT's influence on JAL, have yet to make a clear difference regarding internal strife. Many airline analysts have questioned whether the shift simply indicated that one faction had gained the upper hand for the moment. While everyone agrees that infighting wastes energy and prevents JAL from reacting quickly to new demands, no one has an immediate solution.

Id.

²³⁶ *Id.* JAL's reputation for safety was damaged by the tragedy, even though the crash was attributed to faulty bulkhead repairs by Boeing employees. JAL launched a number of advertising programs emphasizing safety, which ultimately contributed to restricting passenger loads to satisfactory levels. *Id.*

²³⁷ *Id.* at 12.

²³⁸ *Id.* at 12. Passenger revenues, both domestic and international, rose approximately 13%, while cargo revenues remained essentially flat in both markets. *Id.* at 12, 13.

²³⁹ *Id.* at 12.

²⁴⁰ *Id.* at 13. Sale expenditures rose significantly (20%) in FY 1988 and increased by 17% in FY 1989, while operating expenses generally rose by 14% in that year. Sales expenditures as a percentage of total operating expenses have remained steady over the last few years. *Id.*

²⁴¹ *Id.* The level of fixed and other assets increased significantly from FY 1985 to FY 1988 and current assets showed a huge increase in FY 1988. Enhanced capital investment was reflected in the 32% increase in current and long-term liabilities from FY 1985 to FY 1988. *Id.*

²⁴² *Id.* at 12.

JAL appears committed to future improvement of the quality and performance of its equipment, as well as to an aggressive program of diversification.²⁴³ JAL already has the world's largest fleet of Boeing 747's and has placed large orders for current-generation aircraft from the 747-400 series and MD-11 transport planes made by McDonnell Douglas Corp.²⁴⁴ JAL has invested in better ground equipment and maintenance facilities²⁴⁵ as well as the development of advanced hardware and software systems for its computerized reservation systems.²⁴⁶ Finally, JAL intends to raise revenues from diversified operations to 50% of parent company revenues by FY 1992.²⁴⁷

4.2. Railways

The JNR was, prior to its restructuring in 1987, the largest public corporation in Japan. JNR has long had a reputation for outstanding service, including its state-of-the-art high-speed bullet trains and the frequency and punctuality of its regular train service. However, JNR had long been hampered by an uncompetitive cost structure and, as a result, had consistently run large and increasing deficits²⁴⁸ and in the final two years before the railway was restructured had lost more

²⁴³ *Id.* at 14.

²⁴⁴ *Id.* "For example, JAL . . . has firm orders for 40 of the current-generation 747-400 series, which needs only a two-person cockpit crew and offers a 10 percent-plus improvement in fuel efficiency over the 747-300 model. In addition, JAL has placed firm orders for 10 of the MD-11 transport . . ." *Id.* at 14.

²⁴⁵ *Id.* New maintenance and repair facilities not only will be used for its own fleet but may also help JAL secure a share of maintenance contracts from other airlines.

JAL also is investing in automating many labor-intensive maintenance and repair operations, [such as] a new \$8 million washing device [which] allows a four-person crew to clean a 747 jet in an hour . . . a specially designed vehicle that has cut the number of service personnel needed to replace an aircraft wheel from three to one; and a robot window polisher [that] eliminates the costly process of removing scratched windows for replacement.

Id.

²⁴⁶ *Id.* "JAL's AXESS computer reservation system is the most visible part of the firm's . . . \$866.7 million medium-term plan to develop advanced software and hardware systems to provide better service to customers. In cooperation with American Airlines, JAL is working on better transaction-processing software for reservations systems." *Id.*

²⁴⁷ *Id.* "JAL has 17 consolidated subsidiaries (five of which are wholly owned) and a minority interest in another 144 companies. Of special interest to JAL is the hotel and leisure industry, which complements its core operations." *Id.*

²⁴⁸ *OECD Japan 1987/88, supra* note 21, at 85. The Government had been providing substantial subsidies to the JNR, including direct subsidies and interest payments on debt that was assumed by the Government. For example in FY 1985, the level of subsidies equalled 12.1% of JNR's total expenditures and 31.1% of the JNR's "value-added." *Id.*

than \$21.3 billion, bringing its total short-term debt to \$94 billion and its long-term debt to \$157.3 billion.²⁴⁹ Moreover, in contrast to the other public corporations, JNR was always subject to some degree of competition in the passenger market and, in fact, private competitors as a group carried nearly two-thirds of all passenger traffic with just half of the employees.²⁵⁰

As part of Nakasone's privatization strategy, in 1983 the government appointed a special commission and a private advisory board to study JNR's problems and to make recommendations regarding the best way for the government to disengage itself from railway operations, while providing JNR with the best opportunity to solve its own structural problems.²⁵¹ Generally, the JNR was found to be "overregulated, uncompetitive, unresponsive, too big and plagued by poor labor-management relations."²⁵² Specifically, the troubles of the railways could be blamed on a number of factors:

1. JNR's obligation to maintain a uniform network of nationwide service meant that it had to operate a number of unprofitable lines, thereby placing it at a competitive disadvantage.²⁵³

2. Even though JNR continued its development of high-speed trains, it found itself in increasing levels of competition with various substitutes, including domestic airlines for long-distance passengers and road transport for freight and cargo.²⁵⁴

3. The national scope of JNR's activities, as well as the size and dispersion of its workforce, made it difficult for management to exercise any effective control over day-to-day operations.²⁵⁵

The advisory bodies recommended a radical restructuring for JNR²⁵⁶ and, in April 1987, the government split the "old" JNR up

²⁴⁹ JEI REPORT NO. 32A, *supra* note 5, at 17.

²⁵⁰ *Id.* at 18. Private passenger railways had more stations (4,949 versus 4,600 for JNR) and almost the same amount of rolling stock. *Id.*

²⁵¹ Sakoh, *supra* note 22, at 6. Nakasone established a private advisory body, the Special Administrative Research Council, and created the JNR Reform Commission. *Id.*

²⁵² JEI REPORT NO. 32A, *supra* note 5, at 17.

²⁵³ OECD *Japan 1987/88*, *supra* note 21, at 85. For example, JNR's fares in the Tokyo area were often 150 to 200 percent of those charged by competing railways. *Id.*

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ Sakoh, *supra* note 22, at 6. Specifically, the Special Administrative Research Council recommended:

- (1) Eliminating around 20,000 JNR jobs by 1985, bringing the level down to 180,000 by 1987.
- (2) Splitting the national railway system into six regional passenger railway companies and one nationwide freight company in 1987
- (3) Transferring JNR to private management by 1987.

into twelve new units, collectively referred to as the "Japan Railway Group" ("JRG"). JRG consisted of six passenger lines,²⁵⁷ a firm set up to lease bullet trains to the passenger companies and to support the construction of new bullet trains,²⁵⁸ a holding company to handle the old debts of JNR,²⁵⁹ a freight company,²⁶⁰ and three subsidiaries to conduct added activities in technical research, telecommunications and information systems.²⁶¹ JNR's substantial assets — track, cars, rail lines, stations and investments in nonrail enterprises — were divided among the new companies,²⁶² and the total number of employees was immediately reduced by almost 20%.²⁶³ Plans were established for reducing the level of the "old" debt through the sale of assets, including sales to the operating companies,²⁶⁴ and JRG abandoned its prior equipment standard, which allowed it to purchase supplies from cheaper suppliers in the Asian NICs.²⁶⁵

Although the passenger companies were to continue to face stiff competition from their private competitors, particularly in the urban markets, the reorganization appears to have been an immediate financial success from an operational perspective. All six of the operating

(4) Allowing JNR to expand its business into such fields as hotels, shopping centers, and real estate development.

Id.

²⁵⁷ JEI REPORT NO. 32A, *supra* note 5, at 17. East Japan Railway Co., Ltd., Central Japan Railway Co., Ltd., West Japan Railway Co., Ltd., Shikoku Railway Co., Ltd., Kyushu Railway Co., Ltd. and Hokkaido Railway Co., Ltd. *Id.* The passenger lines were to be operated as private firms, although the Government originally retained ownership of their shares. *Id.* at 18.

²⁵⁸ Shinkansen Holding Corp. *Id.* at 17.

²⁵⁹ JNR Settlement Corp. *Id.*

²⁶⁰ Japan Freight Railway Co., Ltd. *Id.*

²⁶¹ The Railway Technical Research Institute, Railway Telecommunication Co., Ltd. and Railway Information Systems Co., Ltd. *Id.*

²⁶² *Id.* at 18. JNR's assets included 200 rail lines, 13,000-plus miles of track, 45,500 rail cars (passenger and freight), 4,600 stations, 226 square miles of land and approximately \$277 million invested in 155 nonrail enterprises. *Id.* "The rapid increases in land prices during the [1980s] has significantly enhanced the value of JNR's holdings, particularly since much of the land was located in city centers." *OECD Japan 1987/88*, *supra* note 21, at 86.

²⁶³ *OECD Japan 1987/88*, *supra* note 21, at 86. Out of a pre-restructuring labor force of 277,020 in 1986, 52,710 left the railways after the restructuring, 200,650 remained with the JRG and 23,660 were employed by the Settlement Corp. *Id.*

²⁶⁴ JEI REPORT NO. 32A, *supra* note 5, at 18. The debt was originally allocated among JNR Settlement Corp. (\$170.7 billion), Shinkansen Holding (\$38 billion) and a group that included three of the new operating companies and the new companies dealing in telecommunications and information systems (\$39.3 billion). *Id.* In turn, JNR Settlement Corp.'s share of the debt was to be reduced by the sale of its real assets, with the new operating companies paying approximately \$95 billion, the sale of land yielding about \$50 billion, and the sale of other assets yielding \$8 billion. *OECD Japan 1987/88*, *supra* note 21, at 86.

²⁶⁵ *OECD Japan 1987/88*, *supra* note 21, at 86.

companies broke even in their first year of operation (FY 1987), and the trends regarding profitability continued for the next two years, allowing them to reduce their share of the debt which they inherited from JNR.²⁶⁶ The favorable results were achieved even though the companies have been unable to increase their fares in the high-volume urban areas and continue to provide service in rural areas where, even though they face little or no competition, services have remained unprofitable.²⁶⁷ JRG's freight business has also been quite profitable.²⁶⁸

On the other hand, the remaining members of the JRG have, for a variety of reasons, been unable to achieve the immediate financial gains realized by the operating companies, although to a certain degree these results reflect the specific objectives of the unit. JNR Settlement was not expected to earn a profit, but rather was organized to reduce the largest portion of the inherited debt. However, due to reduced payments from the operating companies, the need to finance further service expansions and pressure to slow or postpone land sales, the companies' aggregate debt had actually increased to about \$250 billion by March 1990 and interest payments had risen to about \$20 million per day.²⁶⁹ Shinkansen Holding was achieving firm revenues from leasing equipment, although it also had some new debts from financing ongoing construction projects.²⁷⁰ The nonrail companies continued to run significant deficits due to the need to finance various start-up costs of new

²⁶⁶ JEI REPORT NO. 32A, *supra* note 5, at 18. In FY 1987, the group earned \$333.3 million after taxes and in FY 1988 the six companies showed a net profit of \$574 million. In FY 1989, JR East, JR Central and JR West, the three companies which assumed a portion of the JR debt, had net profits of \$444.7 million, \$381.3 million and \$171.3 million, respectively, which permitted them to reduce their share of the debt to no more than \$26 billion. However, the need for the operating companies to reinvest profits to finance new services may substantially lengthen the overall debt-reduction process. *Id.* Also, there is some concern that the three companies which serve the smaller islands, where the volume of traffic is significantly smaller than on the main island of Honshu where the "JR" lines operate, may not be able to sustain the same degree of financial health as the main operating lines, perhaps resulting in the need for another reorganization in the future. *Id.* at 19, 20.

²⁶⁷ *Id.* at 18. "In addition, JRG still must contend with the pork-barrel politics that lead to immensely expensive expansion into sparsely populated areas. The recently completed Seikan tunnel, which links the main island of Honshu with the northern island of Hokkaido, is a marvel of engineering; its cost was so high, however, that it never can be economical. Political pressure reaches even to research activities." *Id.* at 19.

²⁶⁸ The freight business showed pretax income of \$30.7 million in FY 1989, a gain of \$8 million over the previous year. JEI REPORT NO. 32A, *supra* note 5, at 18.

²⁶⁹ *Id.* The Government appears to have asked JNR Settlement to ease attempts to sell its properties in order to assist in cooling the overheated real estate market in Japan. *Id.* In addition, JNR Settlement angered labor unions and politicians when it issued dismissal notices, effective April 1, 1990, to about 2,600 workers who had been cut in the 1987 reorganization and had not yet been reemployed. *Id.* at 19.

²⁷⁰ *Id.*

operations.²⁷¹

Three important aspects of JRG's future development are improvement of the quality and cost-efficiency of its services, its ability to successfully diversify into ancillary services and its ability to use its existing valuable assets, such as its land holdings. Work continues on the development of new high-speed trains, as well as the computerization of reservations, ticketing and information services.²⁷² Also, the ability of the firm to use its railway ties to lease communications cables along JRG rights-of-way, and the firm's efforts to lay a fiber-optic network, may make it a key player in the deregulated Japanese telecommunications market.²⁷³ Finally, non-rail service businesses located alongside railway lines, such as fast-food outlets, sundry stores and newsstands, are natural extensions and may provide a means for employing excess workers.²⁷⁴

A key element of the JRG's efforts to escape from governmental control and achieve managerial autonomy would be some form of stock offering to the public. By August 1990, both JR East and JR Central were profitable enough to be eligible for listing on the TSE, and JR West and the freight businesses were also thought to be near-term candidates for an offering.²⁷⁵ Analysts estimated that the first sale of JR East and JR Central shares, which was scheduled for the fall of 1991, would bring in between \$63 and \$83 billion,²⁷⁶ which could be applied to reduce the mounting JRG debt. Moreover, listing on the TSE would mean that the railroads would be freed from a number of the governmental controls currently in the JR Company Law.²⁷⁷ However, the MOT would still have the authority to regulate fares and services, and

²⁷¹ *Id.*

²⁷² *Id.* at 20. For example, improvements are being made to the "*shinkansen* trains, increasing their energy efficiency, hauling capacity and speed from the current 150 miles per hour average." *Id.* at 20. Research continues on "an experimental maglev ["magnetically levitated"] train with projected top speeds of up to 325 miles per hour. Bringing the prototype to commercial use is expected to cost at least \$25 billion and take until the turn of the century." *Id.* at 19, 20. Interestingly, the award of the building contract for the test track for the project to the home district of a powerful politician touched off a land speculation frenzy which increased the cost of the project and demonstrated the continuing influence of Japanese politics on railway business matters.

²⁷³ *Id.* at 20.

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ *Id.* For example, the JR Company Law required each JRG firm to obtain MOT approval of board member appointments, fund-raising operations and annual business plans. Although the MOT hoped to retain these powers until the government had sold all of its shares, TSE officials successfully argued that removal of these controls was required in order to enhance the attractiveness of the offering. *Id.*

every effort would be made to see that shares were placed in the hands of "friendly" shareholders.²⁷⁸ However, general market difficulties, particularly the performance of the NTT shares, may have severely dampened the enthusiasm for the offering of shares of the JRG companies.

4.3. Tobacco

The JTS, the smallest public enterprise, was established in 1949 to operate the government's monopoly on production and distribution of tobacco projects in Japan.²⁷⁹ JTS operated through a system of official permits granted to tobacco producers, which included a guarantee by the government that production would be purchased, and the appointment of designated retailers.²⁸⁰ Amounts received from consumers were remitted directly to the National Treasury, effectively making the JTS a taxing arm of the government.²⁸¹

Despite strong opposition from various elements within Japan,²⁸² trade tensions with the United States and the general push for privatization led to widescale reforms of the JTS and the domestic tobacco market in the mid-1980s. In 1984, the Diet restructured JTS into Japan Tobacco, Inc. ("JTI"), effective in April 1985, and a portion of the shares in JTI were made available to the public.²⁸³ Also, wholesale business and import activities were liberalized, allowing new foreign and domestic firms to enter the market upon registration with the MOF.²⁸⁴ Finally, restrictions on sales outlets for foreign products were eliminated, as were tariffs on cigarettes.²⁸⁵ JTI retains a monopoly on domestic production,²⁸⁶ along with its purchase obligations,²⁸⁷ but now

²⁷⁸ *Id.* MOT planned to place about 30% to 40% of any publicly offered shares in the hands of "friendly" shareholders. *Id.*

²⁷⁹ *OECD Japan 1987/88, supra* note 21, at 93.

²⁸⁰ *Id.*

²⁸¹ *Id.*

²⁸² Sakoh, *supra* note 22, at 8. Opposition "came from the 90,000 tobacco farmers who wield strong leverage within Nakasone's Liberal Democratic Party. They fear that 'complete' JTS privatization will prompt massive imports of tobacco leaf from at least a score of nations that produce the crop at much lower prices than Japan. Opposition also came from the Ministry of Finance, which feared losing some of the \$1.7 billion annually contributed to the treasury by JTS. And, labor leaders were apprehensive that a reduced Japanese domestic tobacco industry would mean fewer union members." *Id.*

²⁸³ *OECD Japan 1987/88, supra* note 21, at 93; JEI REPORT NO. 32A, *supra* note 5, at 15.

²⁸⁴ JEI REPORT NO. 32A, *supra* note 5, at 15.

²⁸⁵ *Id.*

²⁸⁶ Sakoh, *supra* note 22, at 8. The Administrative Reform Council, Nakasone's private advisory body, had called for completely abolishing the JTS monopoly powers on tobacco manufacturing. *Id.*

²⁸⁷ JEI REPORT NO. 32A, *supra* note 8, at 15.

has more managerial independence and freedom to compete with new foreign entrants.

JTI faces a number of future challenges. While analysts expect JTI to maintain its dominant market position for sometime to come,²⁸⁸ several foreign firms have made significant inroads into the Japanese cigarette market.²⁸⁹ More important, total cigarette sales increased by less than two percent (2%) in FY 1989;²⁹⁰ government restrictions on advertising, including the need to provide health warnings on cigarette products, have made it extremely difficult to expand the domestic market.²⁹¹ As a result, JTI is struggling to develop new products, reduce production costs and penetrate export markets.²⁹² However, each of these strategies may prove to be extremely difficult to execute.

JTI's market problems are reflected in its mixed financial performance over the last several years.²⁹³ This market strategy has led to a flattening of net sales since FY 1982 and due to increases in outlays for sales and marketing JTI's net income has declined over the same period.²⁹⁴ The former transfers to the National Treasury have been

²⁸⁸ *Id.* at 16.

JT's Mild Seven family of products continues to account for more than 40% of all cigarette sales in Japan. Combined with its other domestic brands — Cagin, Caster, Seven Stars and SomeTime — and foreign-licensed brands — Marlboro, Peace, Frontier, Hi-Lite and Hope — JT commanded a little less than 86% of the Japanese market in FY 1989. The only foreign product to make the list of 10 best-selling cigarette brands was Lark Milds in tenth place.

Id. at 16.

²⁸⁹ Three foreign firms have made the biggest inroads into Japan's cigarette market. Phillip Morris Inc. (who sells Lark, Parliament and Merit brands) led the pack with an estimated 8.3% market share in FY 1989, followed by Brown & Williamson Tobacco Corp. (maker of Kent and Lucky Strike brands) at three percent (3%) and R.J. Reynolds Tobacco Co./M.C. Tobacco Co. (Vantage brand) at 1.9%. With all other imports accounting for about one percent (1%) of the market, foreign brands made up about 14% of overall consumption in the April 1989-March 1990 period. Observers predict that this share will rise to 20 percent within a few years; particularly since JT must use uniform domestic leaf (which it blends with leaf produced overseas) and the fact that JT cannot compete with the cachet of foreign brands. *Id.* at 15, 17.

²⁹⁰ *Id.* at 15.

²⁹¹ *Id.* at 16.

²⁹² *Id.* at 17. "Export market development poses some tough questions. Antismoking sentiment in advanced and developing countries is gaining strength, threatening ambitious expansion plans. While the Eastern European and the Soviet markets are attracting interest from American and Western European tobacco firms, JT has yet to make a move into these potentially lucrative areas." *Id.* at 17.

²⁹³ *Id.* at 16.

²⁹⁴ *Id.* Net sales, which stood at ¥ 2,815 billion for FY 1982, actually declined steadily over the next few years to stand at ¥ 2,724 billion for FY 1988. S. G & A expenses rose from ¥ 184 billion for FY 1982 to ¥ 254 billion for FY 1988. Income before taxes, which is the only comparable measure of profitability given the intervening privatization, for FY 1982 (¥ 93 billion) declined to ¥ 85 billion for FY 1988.

replaced by the imposition of a Tobacco Excise Tax and, like the other provalizial companies, income generated by the JTI is now subject to income taxation.²⁹⁵

Although the firm cannot abandon its core business lines, the ultimate answer for JTI may come from diversification, including "manufacturing consulting, machine engineering services, and a line of agricultural products, such as seeds, fertilizers and pesticides, as well as the development of a prescription and over-the-counter pharmaceutical business."²⁹⁶ Also, in an attempt to counter any negative image created by its cigarette products, JTI "has opened a chain of health clubs and introduced a line of health and sports drinks," as well as "food products appealing to the health conscience."²⁹⁷ However, profits from these ventures are still too small to have a meaningful impact on the bottom line; management concedes that significant amounts of further investment will be required in order to achieve their objectives.²⁹⁸

5. PRIVATIZATION AND THE JAPANESE CAPITAL MARKETS

5.1. *Background*

While deregulation and enhanced competition were clearly the primary purposes of the measures adopted in 1985, the government's fiscal woes made the sale of shares in the new privatized companies a high priority. Not only would the sales generate revenues which could be used by the government for other public purposes, such as the retirement of outstanding debt and the funding of new public works projects, but the government's ability to discontinue funding of deficit operations for the corporations was also anticipated to have a positive net effect on the fiscal health of the nation. While it was originally intended that the government would sell up to two-thirds (2/3) of the NTT shares to the public, liquidate its remaining investment in JAL and, if appropriate, "spin-off" a portion of its interest in the regional railways and other members of the new JRG, circumstances ultimately changed the economic and political environment in which the sales were to be effected. However, the activity ultimately generated by privatization of the mammoth public corporations has had a profound effect on Japanese capital markets and their allied institutions.

Id. at 16.

²⁹⁵ *Id.* at 16.

²⁹⁶ *Id.*

²⁹⁷ *Id.*

²⁹⁸ *Id.*

5.2. *Offering and Trading of NTT Shares*

In October 1986, "the government sold 200,000 shares of NTT stock on an auction basis," the first to be offered to the public.²⁹⁹ The purpose of the auction was to establish the price at which the remaining 1,700,000 shares in the offering were to be sold. In the auction, "each bidder was required to purchase a minimum of 100 shares and a maximum of 20,000 shares if they won the bid."³⁰⁰ As a result, "502 institutional investors and 191 individuals proved to have made successful bids . . . rang[ing] from a high of 2.39 million yen per share to 1.017 million yen per share," with 90% of the chosen bids falling under 1.4 million yen.³⁰¹ The weighted average share price of the successful bids was 1.197 million yen per share (approximately \$7,500 per share based on a then-current exchange rate of 160 yen per dollar), which was the price set by the government for the offer of the remaining shares.³⁰² From the auction itself, the government has raised almost 240 billion yen, the equivalent of \$1.5 billion.³⁰³

In November 1986, the remaining 1,700,000 shares in the first offering were made available to the public by an application process.³⁰⁴ Each applicant was limited to one share and, since the government received approximately 10.7 million applications, the purchasers were determined by lottery.³⁰⁵ The "successful applicants were announced on December 29, 1986, . . . [and] in this first sale of NTT shares, the Japanese government is estimated to have received 2.3 trillion yen," or approximately \$14.6 billion, an amount equal to about 4.25% of government revenues in fiscal year 1987, or about 20% of the new public debt in that year.³⁰⁶ The initial public offering of NTT's shares was so large that the proceeds exceeded, by more than three times, the total amount raised in all of the other public offerings on Japanese ex-

²⁹⁹ JAPAN FIN. L., March-April 1987, at 14.

³⁰⁰ *Id.*

³⁰¹ *Id.* The ten largest successful bidders in the auction and the number of shares purchased by them in the auction was as follows: Pacific Mutual Life Insurance (10,000), Daiwa Bank (10,000), Toyo Trust Bank (10,000), Yasuda Trust Bank (7,200), Sumitomo Mutual Life Insurance (7,200), Chuo Trust Bank (3,500), Sumitomo Trust Bank (3,500), Matsushita Electric Industrial (3,000), NTT Employees Shareholding Group (2,800) and Junichi Niwasaki (2,400). *Id.*

³⁰² *Id.*

³⁰³ *Id.* The computation of the amount raised by the Government from the initial auction is based on a then-current exchange rate of 160 yen per dollar.

³⁰⁴ *Id.*

³⁰⁵ *Id.*

³⁰⁶ *Id.*; JAPAN FIN. L., June 1987, at 15. The computation of the amount raised by the Government from the initial auction is based on a then-current exchange rate of 160 yen per dollar.

changes during 1985.³⁰⁷

"The shares of NTT were to be listed on all eight of the Japanese stock exchanges from February 1987."³⁰⁸ In order to list the shares on the Tokyo Stock Exchange ("TSE"), a number of listing conditions were waived, including the requirements that listed shares make up more than 50% of the company's issued and outstanding shares and that the company disclose its five year earnings history.³⁰⁹ NTT shares were listed on the TSE's First Section, a rarity in that companies generally commence trading on the Second Section.³¹⁰ In contrast to every other firm listed on the TSE, except KDD, foreign ownership of NTT shares was prohibited, although observers felt that foreigners could acquire some economic interest in, if not the right to vote, the shares through various arrangements.³¹¹

NTT's shares proved to be a spectacular success, at least in the early months of trading, for investors fortunate enough to have purchased shares in the auction and application process. In the first eleven days of trading in February 1987, the share price actually doubled to 2.4 million yen and, on one trading day, the volume in NTT shares exceeded 43 trillion yen, an amount which was greater than the aggregate trading volume on West Germany's stock exchanges. When the share price rose further, to 3 million yen (approximately \$21,000 per share based on a then-current exchange rate of 143 yen per dollar), NTT had clearly become the world's largest corporation, at least in terms of market capitalization, with a value that was "more than four times larger than that of the previous leader IBM and ten times that of AT&T."³¹² As might be expected, a good deal of the demand for the

³⁰⁷ JAPAN FIN. L., March-April 1987, at 13.

³⁰⁸ *Id.* at 14.

³⁰⁹ *Id.* Obviously, only 12.5% of the NTT shares were originally listed, with the remaining shares owned by the Government. Since NTT was only recently privatized, it could not satisfy the five year earnings and disclosure requirements. *Id.* at 15.

³¹⁰ *Id.* at 14.

³¹¹ *Id.* at 15. For example, "foreigners may be able to obtain NTT shares by arranging that there be no name transfers on shares, or by making investment via fund trusts or designated monetary trusts (*tokkin*).³¹² Actually, the Asian Wall Street Journal reported on May 11, 1987 that the Government believed that foreigners may have held up to five percent (5%) of the then-outstanding public shares (*i.e.*, five percent (5%) of the 12.5% outstanding shares), attributing those holdings to shares purchased from Japanese and foreign securities firms which were members of the TSE who originally purchased the shares for their own account with the intent of subsequent resale to their foreign customers. JAPAN FIN. L., June 1987, at 16.

³¹² JAPAN FIN. L., March-April 1987, at 1. In addition to NTT, eight other Japanese companies stood among the twelve largest corporations in the world in terms of market capitalization. Among the firms were Tokyo Electric Power (3rd), Sumitomo Bank (4th), Nomura Securities (5th), Industrial Bank of Japan (6th), Dai-ichi Kangyo Bank (7th), Mitsubishi Bank (8th), Fuji Bank (9th) and Sanwa Bank (11th). IBM

shares came from institutional investors, who sought a close and strong relationship with this new market behemoth, and Japanese securities firms angling for a portion of the underwriting work that was anticipated from future government offerings. However, individual investors were also well represented, and stockbrokers attributed their "record breaking business results to the opening of 180,000 new accounts by individual investors buying the shares of NTT."³¹³ As of the end of its March 1987 business year, NTT had the largest number of shareholders, about 700,000, among the listed corporations in Japan.³¹⁴

The first NTT share offering produced exactly the type of revenue source upon which the government had relied. As the share price remained strong, even after the market crash of October 1987, when NTT shares fell eight percent (8%) to around 2.8 million yen, as opposed to a general reduction in the TSE of about 16%, investors looked forward to the next offering of 1.95 million shares in November 1987.³¹⁵ In that offering, which was made by direct sales to securities firms rather than through the auction process,³¹⁶ the government raised an additional five trillion yen at a price of 2.6 billion yen³¹⁷ (approximately \$19,000 per share based on a then-current exchange rate of 137 yen per dollar), again representing a significant portion of the government revenue (9%) and new public debt (48%) for that fiscal year.³¹⁸ After the second offering, the 25% of NTT shares that were tradable on the TSE represented 21% of the total value of that exchange.³¹⁹

In addition to the revenues received from the sale of shares, the government also stood to benefit from dividend payments and corporate income taxes received from the newly privatized firm. For example, in the fiscal year ended March 1988, the government received nearly \$500 million in dividends from NTT and collected another \$1.5 billion in

(2nd), Exxon Corporation (10th) and General Electric (12th) completed the list. Of the firms, NTT represented the largest percentage (11.2%) of its nation's stock market, as compared with 3.7% for IBM, the runner-up. JAPAN FIN. L., June 1987, at 1.

³¹³ *Id.* at 18.

³¹⁴ *Id.* at 16. The previous leader, Tokyo Electric, had about 380,000 shareholders. Other than the MOF, which remained the largest shareholder, the largest holders of NTT shares as of the end of March 1987 included Sumitomo Life Insurance, Sumitomo Trust Bank, Toyo Trust Bank, Chuo Trust Bank, Yasuda Trust Bank, Mitsubishi Trust Bank, Yasuda Trust (Tokkin), Mitsui Trust Bank and NTT Employee Holdings. Holding among this group ranged from 26,266 shares to 12,811 shares. *Id.*

³¹⁵ *Id.* at 15.

³¹⁶ *Id.* at 16.

³¹⁷ *Id.* at 15.

³¹⁸ JAPAN FIN. L., June 1987, at 15.

³¹⁹ *Id.*

corporate income taxes.³²⁰ As such, the government had a significant interest in NTT operations, including such traditionally internal matters as corporate dividend and tax policies. Such a situation created the possibility that any governmental policies regarding competition and regulation might, to some extent, be influenced by the government's interest in the financial success of NTT. Moreover, within the government, each of MPT, MOF and MITI also had a strong interest in the viability of NTT in the years to come,³²¹ a situation which may have tended to create a strong assumption on the part of investors, particularly individual investors, that the government would act in a manner which would *preserve* the value of NTT equities.

The surge in the volume of activity on the TSE, as well as the volume of funds realized by the government from NTT sales and dividends had, at least in part, an indirect effect on Japan's overall trade balance relationship with the United States. The NTT offering opened up new domestic opportunities for institutional investors in Japan, which had previously funneled their funds to government and private securities in the United States.³²² Also, the government's ultimate decision to use a large portion of the proceeds from the NTT sales to fund public works projects, which would have the effect of stimulating demand within the country, rather than to retire some of the outstanding

³²⁰ *Id.* at 16.

³²¹ MPT's interest in the performance of NTT stemmed, to some degree, from the traditional measures of bureaucratic success which have existed in Japan since the late 19th Century. Ezra Vogel has noted that "Since the late nineteenth century, Japanese society has measured the success of bureaucrats concerned with various sectors of the economy by the achievements of their sector. This accountability provided the personal drive for bureaucrats that sustained a tradition of governmental assistance to industry. Beginning at the same time, American society measured the success of comparable bureaucrats not by the achievements of the sector under them but by how well they enforced the rules, and this sustained a tradition of adversarial relations and control over industry. The Japanese bureaucrat responsible for the success of his industry has a powerful incentive to help his team do well against rivals, foreign or domestic . . ." See Vogel (1985) at p. 166, as quoted in JAPAN FIN. L., June 1987, at 16. MOF had a financial interest in the proceeds from NTT offerings and dividend and tax payments and, as a result of a last-minute accommodation at the time that the privatization and liberalization measures were passed, MITI had an indirect interest in the dividend proceeds used to fund the Japan Key Technology Center, which was managed by MITI and was to conduct research under the rubric of the "Advanced Telecommunications Research Institute International" in four major areas: intelligent communications, telephone (realtime) translation, human auditory and visual mechanisms, and light-wave and radio-wave communications. *Id.* at 14-16.

³²² JAPAN FIN. L., March-April 1987 at 1-2. Japanese investors had accumulated large holdings in government securities in the United States. Some feared that a fall in demand would lead to higher interest rates in the United States, thereby exacerbating the existing government spending deficit in that country. On the other hand, analysts thought it would be unlikely that Japanese investors would take any action which might diminish the value of their existing holdings. *Id.* at 2.

public debt, was a reaction to criticisms that Japan had no real desire to take steps to alleviate tensions caused by the large current account deficit between Japan and the United States.³²³

The privatization of NTT also created a number of new opportunities in the financial area as the firm took to developing and offering new securities instruments,³²⁴ sometimes turning to one or more foreign securities firms for assistance. Even prior to the initial equity offering, NTT became the fifth Japanese company to issue Euroyen straight bonds, completing a 50 billion yen deal in September 1986.³²⁵ In addition, NTT made a private placement of a 200 million swiss franc straight bond issue with the aid of Swiss Union Bank.³²⁶ In fact, the Swiss firm underwrote the entire issue itself, making it the first offering by a Japanese firm that did not include a Japanese bank or securities firm as lead manager or sub-manager.³²⁷

The MOF scheduled a third offering of another 12.5% of the shares for November 1988, with the intent that the shares be offered at 2.47 million yen (approximately \$18,430 per share based on a then-current exchange rate of 134 yen per dollar), a level which established a price-earnings ratio of about 220.³²⁸ If completed on those terms, the new shares would have raised an additional \$36 billion, and the total revenues from share sales would have been about \$88 billion, valued at the currency exchange rate at the time of the offering.³²⁹ However, 1988 saw the beginning of a continuing erosion in the stock price for the NTT shares. In the wake of the Recruit scandal³³⁰ and the overall

³²³ Originally, the Government had been criticized for its original intention of using the proceeds from the offering to retire the "deficit-financing" bonds issued in prior years and, at the same time, imposing a sales tax increase which, if undertaken, would have the effect of further reducing domestic demand at a time when the NTT sales created a revenue source which exceeded the anticipated proceeds from the sales tax increase. *Id.* at 1.

³²⁴ Privatization meant that NTT could no longer depend upon Government funding for its budget, operations and research. As such, the company needed to develop its own sources of new funding, particularly since the proceeds of the sale of its shares went directly to the Government, rather than to the firm for its own internal use.

³²⁵ JAPAN FIN. L., March-April 1987, at 15.

³²⁶ *Id.*

³²⁷ *Id.*

³²⁸ JAPAN FIN. L., June 1987, at 15-16.

³²⁹ *Id.* at 15.

³³⁰ Former NTT President Shinto was found to be at the center of the Recruit Cosmos Co., Ltd. scandal in that he allegedly tried to secure Prime Minister Nakasone's favor by buying American supercomputers to assist in easing bilateral trade tensions and then turning around and immediately reselling those computers, at a reduced price, to the parent company of Recruit Cosmos. JEI REPORT No. 32A, *supra* note 5, at 6. In light of the reported insider trading profit-taking by key political figures and businessmen in Recruit Cosmos stock, Shinto was put on trial for bribery, a move

deterioration of values in the Japanese securities markets, NTT's share price dropped substantially, eroding the confidence placed in the shares by individual investors who could ill afford the paper loss in their investment.³³¹

In the face of weak demand, the third sale of shares in October 1988 was actually held at only 1.9 million yen per share (approximately \$12,667 per share based on a then-current exchange rate of 150 yen per dollar). Although the MOF encouraged brokerage firms to support the price of the shares following the second and third offerings, neither the MOF nor the broker could forestall further depreciation in the value of the shares.³³² Additional offerings in 1989 were delayed in deference to the bull market, and NTT and the MOF have been left to find a way to restore public confidence in the firm.³³³

The share price fell further in the general market contraction during the first quarter of 1990, dropping to less than its initial offering price by mid-March.³³⁴ More importantly, NTT shares did not join in the recovery which began during the second quarter of 1990 and by late July 1990 had depreciated to one million yen.³³⁵ As of the end of August 1991, NTT's share price stood at 758,000 yen (approximately \$5,500 per share based on a then-current exchange rate of 137 yen per dollar),³³⁶ meaning that investors who had purchased NTT shares in the initial auction lost about 37% on their original investment and that investors who bought shares when the price had reached its high of 3,000,000 yen per share in the frenzy which followed the initial offering had lost fully 75% of their original investment.

5.3. *Offering and Trading of JAL Shares*

In addition to the offer and sale of NTT shares, the government anticipated significant additional revenues from sales of its remaining 34.5% in JAL in autumn 1987.³³⁷ Like NTT, JAL, which was subject

that was particularly shocking in light of the great respect in which he was held in the political and investment communities. *Id.* at 7.

³³¹ *Id.* at 7. "Ninety-eight percent of all NTT shareholders are individuals," as of the date of the report (August 1990), although they only held 17.5% of the outstanding shares. *Id.*

³³² *Id.*

³³³ *Id.*

³³⁴ In mid-March 1990, NTT's share price stood at 1.18 million yen per share (approximately \$7,867 per share at the then-current exchange rate of 150 yen per dollar). *Id.* at 6.

³³⁵ *Id.*

³³⁶ The figures are based on closing prices for the NTT shares. Wall St. J., Aug. 28, 1991, at C10.

³³⁷ "The MOF held 49% of the stock of JAL at JAL's founding in 1951 . . . the

to restriction on the amount of its shares which might be held by foreigners,³³⁸ already enjoyed a significant market capitalization, particularly when compared with that of the other privatized airlines around the world.³³⁹ Although JAL had experienced some earnings problems during the prior year, the price for its shares had remained strong and, in fact, had doubled since October 1986, perhaps anticipating the government offering.³⁴⁰ It was estimated that the government would receive anywhere from 36 to 600 billion yen (over \$4 billion based on a then-current exchange rate of 150 yen per dollar) from the sale of the JAL shares and, "in order to obtain the highest possible share price [JAL] is assuring investors that it plans to revive its dividend by the March 1988 term."³⁴¹

One of the most interesting aspects of the JAL offering was the announced intent to place "over one-half of the shares . . . in the hands of stable-shareholders, such as financial institutions who [would] hold the shares on a long-term basis, rather than as traders."³⁴² Of the 48,099,000 shares which were still owned by the government, Japanese banks were to purchase 12,000,000 shares, or 25%, of the offering,³⁴³

as sold to Japanese nationals." JEI REPORT NO. 32 A, *supra* note 5, at 11. The actual timing of the sales depended upon the resolution of the debate in the Diet regarding the LDP's tax increase proposal and the date that the second set of NTT shares were to be offered. JAPAN FIN. L., June 1987, at 16.

³³⁸ Specifically, holdings of foreigners in all Japanese airlines could not exceed more than one-third of the company's shares. JAPAN FIN. L., March-April 1987, at 14. Under existing requirements, Japanese airline licenses could be cancelled in the event that foreigners acquired more than one-third of the shares of the licensee firm. *Id.*

³³⁹ Around May 1987, JAL's market capitalization was about \$15 billion, which far exceeded such foreign firms as Singapore Airlines (Market Capitalization: \$5 billion/Public Ownership: 37%), British Airways (Market Capitalization: \$2.5 billion/Public Ownership: 100%) and KLM (Market Capitalization: \$2 billion/Public Ownership: 61%). At that time, privatization was proposed for a number of other government-managed airlines, including Air Canada, Air New Zealand, Australian Airlines, El Al, Mexicana and Qantas. JAPAN FIN. L., June 1987, at 16.

³⁴⁰ *Id.* Analysts pointed out that JAL's price-earnings experience evidenced the fact that share prices in Japanese markets often bore little, if any, relation to the underlying profitability of the company. *Id.*

³⁴¹ JAPAN FIN. L., May 1987, at 19.

³⁴² JAPAN FIN. L., March-April 1987, at 14.

³⁴³ The alliances with Japanese banks made sense for a number of reasons. Upon privatization, "JAL w[ould] no longer be able issue government guaranteed bonds [to finance its operations] . . . [and will] substantially increase its borrowings from banks. JAL plans to give greatest priority to banks with the large holdings of JAL shares." In fact, JAL actually stipulated the desired shareholdings of the 16 major banks following the offering. See JAPAN FIN. L., May 1987, at 19, for a list of the major bank shareholders of JAL and the amount that JAL had asked such banks to hold following the offering. The sale of the remaining shares would also mean that a number of additional changes would be made to the manner in which JAL was operated. For example, the Government would no longer be able to intervene in JAL affairs by "appointing airlines executives and auditors, and the authorization of the government" would no

"life insurance companies [would purchase] 5.6 million shares, non-life insurance companies [would purchase] 2.7 million shares, other financial institutions [would purchase] 100,000 shares and business association corporations [would purchase] 3.9 million shares."³⁴⁴ As a result, financial institutions would hold more than 40% of the outstanding securities of JAL after the offering.³⁴⁵

The JAL offering, as well as the activity created by the sale of the NTT shares, increased the value of other stocks in the airline industry. For example, when TDA undertook to list its shares on the over-the-counter market in late March 1987, shares were initially priced at 7,260 yen per share.³⁴⁶ However, "during the first day of trading shares prices reached as high as 30,000 yen per share . . . [giving] the company a price earnings ratio of 519 times, [based on earnings forecasts for the then-current year], and a total market capitalization of 570 billion yen, a record for a company which [did] not pay dividends."³⁴⁷

6. CONCLUSION

6.1. *The Rise and Fall of Tokyo's Equity Markets*

By the late 1980's, Japanese securities markets rose and fell with increasing independence from the performance of shares in New York and London.³⁴⁸ In late 1986 and early 1987, trading volume, and profits for Japanese securities firms,³⁴⁹ increased substantially on the Tokyo markets due, in part, to the first offering of NTT shares, general bullish sentiment and the entry of new capital from institutional investors fleeing a bond market depressed by rising interest rates.³⁵⁰ As noted above, the NTT offering brought many new individual investors into the equity markets and, in the first four months of 1987, the average daily turnover in the Tokyo exchanges soared to over 1.2 billion

longer be required in order for JAL to "issue bonds, dispose of profits [through the payment of dividends], borrow long term funds, amend [its] articles of incorporation and sell or acquire aircraft." *Id.*

³⁴⁴ JAPAN FIN. L., June 1987, at 16.

³⁴⁵ *Id.*

³⁴⁶ JAPAN FIN. L., May 1987, at 19.

³⁴⁷ *Id.*

³⁴⁸ Graven, *Tokyo Market Is Setting Its Own course*, Wall St. J., Oct. 16, 1987, at 41, col. 1. (Hisamichi Sawa, First Vice President, Prudential-Bache Securities (Japan) Ltd., was quoted as saying "The correlation between price movements in New York and price movements in Tokyo is becoming less and less.").

³⁴⁹ Under pressure from the United States, some foreign firms were provided with some access to the booming Japanese markets. For example, three United States firms were part of the underwriting syndicate for an NTT offering. Wall St. J., Nov. 20, 1987, at 1.

³⁵⁰ Graven, *supra* note 348.

shares compared to an average of 708.6 million shares in 1986 — a 66% increase over the prior year.³⁵¹

From December 1984 to December 1989, participants in Japanese equity markets were rewarded with spectacular rates of return. During that period, the Nikkei Index rose 237% and the yen rose 75%, meaning that, in dollars, the Tokyo market provided a 42.7% compound annual rate of return.³⁵² The rise in share prices far exceeded gains in corporate earnings during that period and, by the end of 1987, the overall price-earnings ratio soared to 53, while the ratio in the United States at that time stood at “just” 14.4.³⁵³ Analysts attributed the wide differential in values between shares in Japan and the United States to a “liquidity build-up” created by the current account surplus during that period; most of the build-up was retained in the corporate sector for further investment rather than distributed to the public to increase consumer spending and reduce the trade-related surplus.³⁵⁴

However, the new decade has brought trouble to the Tokyo markets. First, the growth in the Japanese money supply, which had been held to a steady, non-inflationary annual rate of seven to eight percent until early 1987, rose to nearly 11% during 1987-89, providing more people with money to spend on imports which would reduce the current account surplus.³⁵⁵ Second, large increases in the value of the yen between 1986 and 1989 contributed to higher import levels.³⁵⁶ Third, real wages increased substantially in 1988 and 1989, leading to further domestic consumption.³⁵⁷ In short, a number of factors combined to stop the growth in the current account balance and, after reaching its peak of \$87 billion in 1987, the surplus fell - to about \$40 billion in

³⁵¹ *Id.*

³⁵² Gressel, *Tokyo - A Stock Market Like Any Other*, Wall St. J., Apr. 3, 1990, at A20, col. 3.

³⁵³ *Id.*

³⁵⁴ *Id.* To be sure, a good deal of the current account surplus was used to purchase comparatively cheap stocks, bonds and real estate abroad, particularly in the United States. However, as the Japanese markets continued to rise and the value of the dollar fell, thereby reducing the value of any existing foreign investments, institutional investors in Japan poured more and more capital into domestic stock markets. *Id.*

³⁵⁵ *Id.* The acceleration in the growth of the Japanese monetary supply was caused, in part, by attempts to adhere to the Louvre Accord of 1987. *Id.* It should be noted that the increase in the money supply not only led to more consumer spending but also allowed corporations to raise additional capital at very low interest rates. Therefore, in 1990, Japanese corporations spent \$660 billion on plant and equipment, while corporations in the United States spent only \$510 billion. Barnathan, et. al., *Hidden Japan: How the System Really Works*, INT'L BUS. WK., Aug. 26, 1991, at 14-22 [hereinafter *Hidden Japan*].

³⁵⁶ Import volumes rose 37.5% between 1986 and 1989. Gressel, *supra* note 352.

³⁵⁷ Real wages increased 3.3% in 1988 and about 2.4% in 1989. *Id.*

1990.³⁵⁸ As a result, the "liquidity build-up" was dissipated, and share prices began to fall to a level commensurate with general economic conditions as they existed five years earlier.³⁵⁹

In many ways, the rise and fall of the NTT shares,³⁶⁰ the massive revenues received by the government and securities dealers from sales of, and trading in, NTT shares, and the severe losses borne by individual investors with respect to their investment of savings in NTT shares illustrates much of what concerns domestic and foreign observers of the Japanese securities markets. Recent scandals in the banking and securities industries have shaken the political and financial infrastructure that has led Japan to the heights of economic prosperity, leading analysts to the following criticisms:³⁶¹

1. LDP politicians, who have dominated the Japanese political leadership since the beginning of the post-War recovery efforts,³⁶² appear to have used their relationships with brokers and major institutional investors to manipulate prices on the Tokyo securities markets to their advantage.³⁶³ Moreover, in spite of the announced intention of liberalizing Japanese telecommunications markets and dismantling some of the inherent competitive advantages retained by NTT following its privatization, NTT remains a dominant factor in the industry and, not surprisingly, a major contributor to the LDP.

³⁵⁸ *Id.*

³⁵⁹ *Id.* By comparing such major macroeconomic statistics as domestic inflation rate, current account surplus, interest rates and the price of oil, Gressel concluded that Japan's "situation" as of the end of 1989 was roughly equivalent to that which existed at the end of 1985, when the market's price-earnings ratio closed at 26. *Id.* As such, the Nikkei Index would have had to fall to the 18,000 to 20,000 range in order for the price-earnings ratio to return to the appropriate level; in fact, the Nikkei Index closed at 21,641.30 on August 27, 1991. San Francisco Examiner, Aug. 27, 1991, at B-3. It should be noted that Japanese ratios "ought" to be higher than those in the United States due to the high rates of economic and productivity growth expected in Japan. Gressel, *supra* note 352.

³⁶⁰ As of August 28, 1991, NTT shares were trading at \$5,500 per share, based on a closing price on that day of 758,000 yen per share and an exchange rate of 137. Wall St. J., Aug. 28, 1991, at C1, C10.

³⁶¹ Based, in part, on the discussion in *Hidden Japan*, *supra* note 355, at 14-22.

³⁶² In fact, the LDP is divided into five factions, each with a forceful leader. The most powerful bloc is the Takeshita Faction named for former Prime Minister Noboru Takeshita, leader of the construction "zaku," who was forced to resign in the wake of the Recruit scandals. Prime Minister Toshiki Kaifu belongs to the Komoto Faction, the smallest of the factions with little influence. However, Kaifu remained a viable candidate precisely because he had, at least until now, appeared to have steered clear of the scandals which brought down Takeshita and sullied others within his own Faction. *Id.* at 20-21.

³⁶³ As noted in *Hidden Japan*, "[S]ecurities heavies often pump up prices of shares held by LDP politicians." *Id.* at 16. These "donations," estimated by one source to amount to about one-half of all LDP funding, gave the brokers significant influence. *Id.* at 16.

2. Both the MPT and NTT are managed by LDP appointees under the direction of the telecommunications “zoku,” an informal “tribe” of Diet members from the LDP who intercede on behalf of various interest groups in the course of policy deliberations on domestic and foreign policies.³⁶⁴ As such, critics note that while NTT has, at least on paper, been “freed” from government control, it continues to operate very much in accord with the wishes of the majority party. Policy continues to be based more on personal relationships than on dispassionate enforcement of laws.³⁶⁵

3. The MOF, which is also managed by one of the leaders of the controlling faction of the LDP,³⁶⁶ not only controls fiscal and monetary policies, including the decision as to when additional shares of NTT stock were to be offered to the public, but also acts as the “regulator” of the securities, banking and insurance sectors of the economy.³⁶⁷ As such, the MOF was positioned to orchestrate sales of the NTT shares through brokers at premium prices, thereby increasing government revenues and brokerage commissions, which are fixed by the MOF.

4. Japanese securities firms “cooperate” with the MOF by insuring that initial offerings are placed at premium prices, that shares held in special trust accounts³⁶⁸ for Japan’s major corporate investors and LDP members are “protected” from depreciation,³⁶⁹ and that the markets remain steady in the face of significant downturns elsewhere, as

³⁶⁴ *Id.* at 15, 20. Shin Kanemaru, who is the leader of the telecommunications “zoku,” also heads the Takeshita Faction of the LDP, which is perceived as the most powerful bloc of politicians in the country. *Id.* at 21.

³⁶⁵ *Id.* at 14-15.

³⁶⁶ Finance Minister Ryutaro Hashimoto, who is taking a good deal of the blame for the recent problems in the securities and banking sectors, is a leader of the Takeshita faction and was rumored to be a strong candidate for election as Prime Minister in the elections of October 1991. *Id.* at 20-21.

³⁶⁷ In effect, the MOF has many of the same functions as the Securities and Exchange Commission, the Federal Reserve and state banking and insurance regulators combined. *Id.* at 17. Also, the MOF controls the nation’s taxing authority and the national budgetary process, activities which fall to the relatively independent Internal Revenue Service and Office of Management & Budget in the United States. *Id.* at 17.

³⁶⁸ These funds, referred to as “eigyo tokkin,” were established and managed by the securities firms in order to allow preferred clients to participate in the bull market. *Id.* at 16. Since the recent scandals, the funds have been banned in order to cool speculation and restore some degree of investor confidence in the market and its brokers. *Id.*

³⁶⁹ For example, Hitachi Ltd.’s stock market investments were basically “insured” by Nomura Securities, which paid out \$16 million over the last few years to cover Hitachi’s losses. *Id.* at 14. Now foreign investors, who also suffered losses in the Tokyo markets during that period, are considering legal action against the “Big Four” securities firms which control the industry in Japan. *Id.* Interestingly, concerns about the payments do not appear to stem from any moral compunction, but from the MOF’s aggravation when securities firms attempted to deduct the payments as entertainment expenses for tax purposes. *Id.*

occurred in October 1987.³⁷⁰ In return, the firms realize substantial profits from underwriting fees and commissions, as well as from their own positions in the securities.

5. Individual investors, induced into the market for the first time in 1986 through the NTT offering, stand out as the biggest "losers."³⁷¹ Unable to avail themselves of the protections afforded to institutional investors by the LDP and the securities firms, individuals, many of whom can only afford to buy one or two shares, can ill afford the rapid depreciation in the paper value of their investment. However, it has been observed that consumers, in spite of their losses, accept the "behind-the-scenes" dealings of their politicians and industrial leaders as part of Japanese culture, although their willingness to actually return to the markets has yet to be shown.³⁷²

On the surface at least, many of the main protagonists appear to have taken the lead in repairing the damage which has been done to Japan's global image from the recent disclosures. The MOF itself has moved against various speculative schemes,³⁷³ while a number of proposals, including Prime Minister Kaifu's call for the creation of an oversight agency along the lines of the United States Securities and Exchange Commission, have been advanced for curtailing the ministry's powers.³⁷⁴ The *Keidanren* moved to censure the offending brokers; its chairman, Gaishi Hiraiwa, organized a task force on reform of the financial system.³⁷⁵ However, while many hope that the realization that Japan must now observe global "rules" will upset the traditional structure of power, there will be strong resistance to any reform to a system which has been so successful to all involved, even those individual investors who suffered the temporary setback in the financial markets.³⁷⁶

³⁷⁰ It is generally believed that the MOF, in response to the October 1987 market crash, has continuously pressured brokerage firms to prop up the market and to continue buying United States government bonds in the face of huge losses. *Id.*

³⁷¹ *Id.* at 16.

³⁷² *Id.* at 18. In fact, it has been observed that consumers were more indignant about the imposition of a three percent (3%) consumption tax than about the disclosures in the recent scandals. *Id.*

³⁷³ *Id.* at 16.

³⁷⁴ *Id.* at 18.

³⁷⁵ *Id.* Fired Nomura Securities chairman Setsuya Tabuchi was quickly dismissed as Vice Chairman of *Keidanren*. *Id.*

³⁷⁶ It may be that real reform will not occur until healthy opposition to the LDP emerges. *Id.* at 22. In fact, as this article goes to press, it is apparent that the reforms advanced by Kaifu and others have had little success and that Kaifu himself has been replaced by more traditional elements within the LDP.

6.2. *The Lessons of Privatization*

Privatization is generally considered in the context of actions which might be taken by the government in lesser-developed countries in order to accomplish a variety of social, economic and political objectives.³⁷⁷ However, when the policy is implemented in one of the larger industrialized economies, such as Japan or Great Britain, the lessons may be somewhat different, particularly when the enterprise is one of the world's largest firms operating in a strategic technological industry, such as telecommunications.³⁷⁸ In many ways, it may be premature to posit the ultimate lessons of privatization in Japan, particularly in light of recent events and the possibility that NTT may, within a few years, be once again radically restructured and deregulated. However, the following areas are worth noting:

Market Activity. The NTT offering had a vivid and lasting effect on the growth and breadth of Japan's securities markets in the late 1980's. The overall level of trading activity increased substantially following the sale of the NTT shares; individual investors, enticed by the allure and apparent security of shares in the former public corporation, entered the market in record numbers. As a result, companies attained spectacular price to earnings ratios, far out of proportion to corporate earnings and investment funds were funneled into the secondary trad-

³⁷⁷ Privatization, which is generally defined as the transfer of public assets to private ownership, usually occurs after efforts to control perceived "inefficiencies" of the public enterprise have failed. Not only does privatization offer the possibility of improving the efficiency of enterprises, it also allows firms to gain access to private sector financing and new markets, broadens share ownership, to create a desired link between capital and savings in the economy, and, in many cases, to contribute to the reduction of public sector deficits. See R. HEMMING and A. MANSOOR, *PRIVATIZATION AND PUBLIC ENTERPRISES* (International Monetary Fund, Occasional Paper No. 56, January, 1988).

³⁷⁸ It is important to remember that, for all of its current economic success, Japan was actually a "developing" country as recently as forty years ago, when many of the decisions leading to the modern structure and competitive position of NTT were being formulated and implemented. However, circumstances can change over time such that further economic development requires the use of economic markets dedicated to private profit, rather than a system in which goods or services are produced in accordance with rules and procedures administered by the government. In such cases, privatization of state enterprises may be advocated for various reasons: (1) "private owners who will seek a profit and will be subject to competition (including competition in the capital markets) will have greater incentive" to enhance efficiency of production and distribution; (2) once the basic infrastructure has been developed, further advances can be funded through private capital, allowing government revenues to be diverted to other public uses; (3) private ownership permits the recruitment of "more skilled entrepreneurial and managerial talent" than might be available if the enterprise were operated by the government; and (4) privatization "reduces the danger of excessive government power . . . and reduces the scope for corruption." G. ROTH, *THE PRIVATE PROVISION OF PUBLIC SERVICES IN DEVELOPING COUNTRIES* at 165 (1987).

ing markets in record amounts, leading to substantial commissions and revenues for Japan's large securities firms.

Market Regulation. Ultimately, trading in NTT shares illustrated many of the perceived deficiencies in the regulation of Japanese trading markets by the government, as well as by its own constituent securities firms. Practices which would constitute "insider trading" and market manipulation in the United States were apparently common practice in Japan, and the size of the offer of NTT shares, and volatility of their trading price, combined to undermine the credibility of its market valuation. The continued interest of the government in NTT's share performance, both from a fiscal and, to some extent, personal perspective, was a key element in the ultimate collapse of confidence in the shares.

Underwriting and Distribution Process. The process of distributing the shares of NTT and JAL held by the government is somewhat unique to the Japanese perspective on equity ownership, as are the restrictions placed upon foreign ownership of shares in the entities. The initial NTT offering was priced through an "auction" process, while subsequent NTT offerings, as well as the placement of the final tranche of JAL shares, were accomplished selectively through underwriters and investors who could be counted upon for their "stability" in holding the securities or, in the case of any of the securities firms, to "support" trading activity. An effort made to artificially set trading prices in the subject securities, would be contrary to those restrictions on price manipulation imposed in the United States.

One lesson from the distribution process is well worth noting for firms in the United States. As part of the offer and sale of the JAL shares, major Japanese banks were placed on notice that they were "expected" to purchase a specified portion of the new offering, presumably as a condition of continued participation in the "credit-side" activities of one of the world's largest air transport companies. This practice demonstrates the continued importance of banking relationships in Japan, in spite of the apparent growth of the equity markets. Banks "invest" in their clients in a number of ways, and create strategic relationships that encourage stronger and more active communication than might be the case in the United States.

Fiscal Policies. As a general matter, the relationship between the government's fiscal policy and trading activity in the capital markets is, at best, indirect, except to the extent that offerings of government debt securities "compete" for funds with private issuers. However, the sheer size of the proposed offering of government-held securities, including the NTT shares, as well as the government's need to fund various public works projects and to meet its obligations to service the outstanding

level of public debts, created a unique "public interest" in the market activities of the shares of the former public corporations.

The proceeds from the sale of NTT shares, as well as the new dividend and tax income, allowed the MOF to devote an extra 1.3 trillion yen (\$8.7 billion) a year to public works expenditures starting in Fiscal Year 1988.³⁷⁹ Even though the funds were not diverted to the reduction of public debt, the offering of the NTT shares undoubtedly eased some pressure in the money markets which may have been created had the government needed to issue additional deficit reduction bonds to fund the expansion of domestic demand. Similarly, the collection of "windfall" revenues influenced the debate on the imposition of new taxes.

As noted above, the steep decline in NTT's share price, as well as the general downturn of the Tokyo securities markets, has dampened enthusiasm for future sales of NTT shares.³⁸⁰ Moreover, the stunning lack of confidence in the government has crippled the MOF's strategy of realizing further profits from the sale of shares of other former public corporations, such as the JRG. These firms, although "privatized," are still owned and regulated by the government. This brief "failure" of privatization may ultimately have a significant impact on the policies of Japan's fiscal planners over the coming years, although the impact will be difficult to measure.³⁸¹

Maturation of Japanese Capital Markets. While it is true that the NTT offering, as well as the other economic factors noted above, combined to create the world's largest equity trading market and catapulted Japanese securities firms to the forefront of global activities, it is altogether unclear whether or not Japan's markets truly "matured" during the process. Presumably, the new "public" firms, no longer able to depend upon government financing, would create numerous underwriting opportunities for domestic and foreign securities firms, including the creation of new instruments that could be tailored to the specific needs of firms operating in the telecommunications and transport industries.

An expectation might also be created that new capital market sec-

³⁷⁹ JAPAN ECONOMIC INSTITUTE REPORT NO. 26A at 8 (July, 1990).

³⁸⁰ *Id.*

³⁸¹ It should not be forgotten that, with the exception of the JAL, the "privatized" public corporations are still essentially wholly-owned affiliates of the Government and are independently managed; the Government is, in theory, freed from any obligation to continue direct operational funding of their operations. As such, given the essential nature of certain of the services to be provided by these entities, it is conceivable that the Government may be called upon to provide additional forms of financial assistance to the firms, even if only by pressuring private banks and investors to provide new operating funds when the firms are unable to tap the public securities markets.

tors would evolve as firms move to exploit opportunities in the deregulated industrial sectors, just as the "break-up" of AT&T in the United States led to the development of new businesses, in various forms, focusing upon new technologies, products and services and market niches. For example, in the telecommunications area, new Type I carriers could presumably become candidates for public offerings in the future, as might manufacturers and other firms, of various sizes, which are engaged in providing products and services related to those delegated to the larger firms. Already, Type II carriers which, by definition, are to focus upon specific products and services in niche markets, are demonstrating the scope of structural forms which might be utilized in the environment of deregulated activities.

NTT Corporate Policies. One of the announced goals of privatization for NTT and the other public corporations was to free management from the burden of central government interference in key internal corporate policies. On the other hand, independence meant that the corporations would need to forge their own financial strategies, building relationships with Japanese and foreign banks and investment firms without the benefit of government guarantees. Also, dividend and tax policies were to become important to NTT and the other corporations, as would shareholder relations and the need to draw corporate policies with an eye toward the disclosures which were anticipated from broadly-held issuers.

For all of the foregoing, NTT's continuing domination of Type I carrier services, as well as the massive cash flow which it enjoyed from operations, has resulted in very little change in the manner in which internal finances have been conducted at the firm. NTT is now free to expand into new ventures, often in partnership with other large domestic and foreign firms, and, at least until the recent scandals in the securities markets, key NTT research and development and construction projects were allocated throughout the country with an eye toward LDP politics as much as anything else.

Government and the Capital Markets. We have already observed the impact of government regulation on activities in the Japanese capital markets. However, the lessons of NTT go beyond the promulgation and enforcement of laws directed at manipulative practices to the very essence of the government's role, at least as perceived by elements of the investment community, in insuring the value of funds committed to the public corporations. The interests of government ministries and politicians in the NTT share price, as well as in the regulatory environment in which it operated, have been well chronicled. What now remains is the challenge of restoring the confidence of domestic and foreign inves-

tors in the capital markets process within Japan. While some have suggested that the Japanese create new institutional supports, such as an independent securities regulatory and review body, it is far more likely that the "solution," if it comes, will recognize the unique network of public and private finance that exists within Japan's own far-reaching national industrial policy.

6.3. Conclusion

Privatization in Japan has not fared well in relation to orthodox measures of its efficacy. First, while the NCC's have achieved some degree of profitability and new entrants have overrun the Type II markets, NTT has retained its dominant market position. Second, while significant private investment continues with respect to telecommunications activities, particularly among those large businesses in the Keidenran who are financing the NCC's and new Type II operations, the broader capital markets have yet to benefit from the growth of a new telecommunications sector. Third, the new NTT has *not* led to the development of the requisite independent managerial class; instead, for the reasons cited, NTT operations remain a material function of the MPT, MOF and the LDP.³⁸²

If one were to return to this subject in a few years, it would be interesting to see whether or not the deregulation of telecommunications in Japan really operated to open new and diverse capital market opportunities. Would the main securities exchanges continue as mere trading floors for imprudently priced securities, creating large commissions for brokers, while companies obtained new capital from commer-

³⁸² The proper balance between government intervention and private enterprise with respect to telecommunications policy is by no means a settled issue. For his part, Professor Harris urges Americans to recognize several valuable lessons from the apparent reforms to Japanese telecommunications policy. First, telecommunications is a strategic industry vital to national economic and social welfare; as such, it is too important to be left to courts or regulators. Harris, *supra* note 43, at 21. Instead, the national legislature should assume a leadership role in developing a comprehensive *national* policy for communications and information services. *Id.* Second, "[t]elecommunications policy must balance dynamic, long-term goals in technologically advanced networks, services and equipment industries with shorter run consumer protection interests. [Third, p]olicy should be implemented primarily by a single agency with the incentive, and the necessary tools, to implement policy in a logically coherent fashion." *Id.* at 21-22. Finally, Harris praises the initial decision of the Japanese *not* to "make a forced choice between "monopoly" and "competition" . . . [by] break[ing] up an integrated supplier, or restrict[ing] its scope of operations, in order to promote competition." *Id.* Harris advocates "open access and interconnection, non-discrimination in rates and conditions, and sharing of necessary technical standards and specifications" as an effective "intermediate" approach that combines the best of economies of scale and market integration. *Id.*

cial banking channels? Or would the size of NTT and the markets in which it competes, as well as the technologies upon which the information services markets depend, prove to be a true catalyst for reformed markets in which companies could look for new equity capital and investors? Could employees share in the growth and profitability associated with the performance of the firm? Only time, and the memories of those whose funds may have been dedicated to the original "NTT miracle," hold the answer.

Enterprise	Date of Change Of Status	Current Ownership	Main Remaining Regulations
Nippon Telegraph and Telephone	April 1985	3,900,000 shares sold to Japanese public during 1986/1987 and	More than one-third of total share to remain in government control. Permits control of bylaws. Fares subject to approval of Ministry of Post and Telecommunication. Obligation of uniform service.
Japan National Railways	April 1987	100 per cent JNR Settlement Corporation stock to be sold to public: date not yet set.	Approval of Ministry for fare changes
Japan Air Lines	November 1987	100 per cent private	Controls on fares and routes
Japan Tobacco Inc.	April 1985	100 per cent government One-third of shares to be sold to public at a date not yet set	Retains monopoly of tobacco production, and monopolistic sales of salt

Sources: *OECD Japan 1987/88* at p. 82.