INTRODUCTION

Mitsuhiro Kagami
Masatsugu Tsuji

The 1980s and 1990s might be characterized by the great crusade of market forces against large governments. A notion of 'small government' has been introduced under the UK and US neo-conservative administrations backed by international organizations such as the World Bank and the International Monetary Fund. Along this line of thought, major state-owned enterprises (SOEs) have been privatized and thousands of regulations have been eased and/or abolished.

In advanced countries, many sectors were deregulated under free market mechanisms such as telecommunications, electricity, railways, commercial airlines, the financial sector, and wholesale and retail businesses. For example, UK privatization and deregulation programs were strongly executed under the 1979-97 Conservative governments. Such sectors as telecommunications, energy as well as water were either privatized or deregulated. A typical case is electricity, here the British state electricity monopoly was divided into three regions and privatized, this in turn has led to consumers paying the lowest electricity charges in Europe. In Japan, telecommunications were privatized and the resultant competition brought about cheaper rates and improved services for consumers. In the US, airlines were deregulated and airfares became cheaper. Therefore, overall deregulation resulted in better services and cheaper charges. However, a negative side emerged as well. In the case of the City of London after the series of financial deregulation measures since 1986, foreign banking companies took over the market, the so-called 'Wimbledon effect' or 'Wimbledon phenomenon[1]'. In the case of Japan, deregulation is still delayed, especially, in terms of utility-related prices. In the US, local and uneconomical airlines were marginalized, leaving people in remote areas inconvenienced.

In developing countries deregulation and opening-up is in full swing, particularly, the privatization of SOEs, firstly for fiscal deficit reasons and secondly for liberalization and opening-up processes. Furthermore, deregulation of many business activities is also occurring thereby creating many benefits however, here again, several negative effects on society in general such as unemployment, foreign-capital dominance, oligopoly, and an increase in the income gap can be seen. In several developing countries such as major Latin American countries and India, privatization of SOEs sometimes results in price increases because public utility prices (such as electricity, subway and gasoline) are intentionally kept low (tariffs below marginal cost) partly because of social welfare considerations and partly for populism reasons in the case of Latin American countries. Price increases following privatization do not improve people's perceptions of such policy. Costs are also incurred in setting up monitoring institutions for privatization and deregulation.

One factor which can not be ignored is technological innovation. Generally, SOEs are run by the public sector because of market failures related to economies of scale, externalities and public goods. Recent gas turbines (combined-cycle gas turbines) can efficiently produce electricity replacing large-scale hydroelectric power generating plants. Small but efficient water-treatment machines can substitute for large-scale sewerage works. Similarly, long-distance telecommunications can be carried out at greatly reduced cost owing to the introduction of recent information technologies. Another feature of infrastructure such as electricity, gas, water, telephone, broadcasting, railways, and airlines is that these services have their own network. The wider the network coverage, the more useful (or convenient) it is for clients. This is called network externality. If such a network is liberalized and access to the network is easy and less expensive, there are lots of opportunities for private firms to enter these businesses. Liberalization (flexible perception changes) and technology advances are thus attracting private companies to consider infrastructure services.

In sum, on-going privatization of SOEs and deregulation have been generating fundamental changes in society in the following areas:

(a) the role of government and markets
(b) ownership (domestic as well as foreign participation by foreign direct investment)
(c) performance and services (prices, quality, varieties, etc.)
(d) industrial structure (production and employment)
(e) institutional and contract arrangements (leasing, concession, outsourcing etc.)
(f) financial arrangements (such as private financial initiatives, PFI)
(g) legal frameworks
(h) regulatory or monitoring bodies
(i) consumer attitude and life style

(j) income distribution

This book examines actual situations of deregulation and privatization processes, it looks at progress obtained and the favorable results as well as the negative effects generated by the above-mentioned changes in developing countries and advanced countries and examines the lessons that can be learned from their experiences. PART I introduces the Japan team's papers. M. Kagami focuses on Japan's experience in his paper on "Privatization and Deregulation: The Case of Japan." In general, merits of privatization and deregulation include cost and price reduction, increased efficiency with better business performance, improved services, increased customer satisfaction, and augmented government revenues. Demerits include increased unemployment, reduced labor union power, the appearance of oligopoly or monopoly, foreign capital dominance, the treatment of universal services, and bad debt problems. Kagami highlights two privatization cases: the Japan National Railways and the Nippon Telegraph and Telephone Public Corporation. In the case of Japan, competition brought about price reduction and better services. Unemployment has not been acute due to favorable business cycles up to the mid-1990s. Labor union power has been greatly curtailed. Foreign capital dominance has been avoided by careful and gradual capital deregulation. However, the heavy debt burden of privatized SOEs has not been solved, especially in the case of the Japan National Railways.

M. Tsuji analyses the privatized Nippon Telegraph and Telephone Corporation (NTT), especially, the recent proposed plan to divide NTT into four companies, in his paper, "Deregulation in the Japanese Telecommunications Market: New Regulatory Schemes." He also examines the price-cap scheme for telephone tariffs and universal service. The paper focuses on the current state of discussion in Japan and examines the characteristics of new policies and how they differ from those of other countries. He concludes that NTT seems to lack the incentive to improve efficiency because it has monopolized the market for a long time and the use of the rate-of-return regulation has hampered efforts toward better services, combined with discretionary policies of the Ministry of Posts and Telecommunications.

In her paper, "Financial Liberalization, Deregulation and Monitoring in Japan," C. Kashiwabara examines institutional aspects of monitoring systems in the financial sector which is facing the so-called 'big bang,' particularly, the effectiveness of the newly-established Financial Supervisory Agency (FSA) in Japan. She points out several problems contained in its operation and the importance of the coordination efforts of the Bank of Japan to neutralize the influence of the Ministry of Finance over the FSA.

K. Nishikimi builds a mathematical model in his paper, "Price Regulation and Growth Pattern of Network Industries: A Simulation Analysis" to analyze purely theoretical growth patterns of network formation if price regulations differ. Using a network of libraries, the development patterns of a network map is simulated according to different price policies such as monopoly pricing, average cost pricing, uniform pricing, and universal service pricing.

H. Kim explains the deregulation processes in Korea from the early 1980s to the present in his paper titled "A Review of Korea's Economic Deregulation Policy." He draws some lessons from the Korean deregulation experience, the country once called 'the regulation kingdom': these include the necessity of: (i) stable deregulation institutions to maintain consistent policies; (ii) trained manpower to practice deregulation; and (iii) long-term and wide-ranging views on deregulation rather than short-sighted ones.

PART II contains the UK team's papers. M. Pollitt surveys the process of liberalization of public enterprises in the UK since 1979. He points out in his paper "A Survey of the Liberalization of Public Enterprises in the UK since 1979" that five groups within society which have been affected by the privatization and deregulation of public enterprises: consumers, shareholders, workers, the government and competitor firms. Privatization has generally improved consumer welfare via a combination of higher quality and quantity of output and lower prices. Shareholders have benefited via windfall gains. Workers do not seem to have got lower salaries as a result of privatization if they remained with the company while those who left were re-employed elsewhere in the economy (unemployment fell from 1986) or opted for early retirement. The government gained from large asset sales and additional corporate taxes which helped to reduce fiscal deficits though its involvement in industry diminished. Competitor firms gained almost in all but a few industries as entry barriers were removed. He suggests that the most significant aspect of the UK privatization program was the political advantage gained by pro-market forces because privatization was the most sustained and consistent policy of the 1979-97 Conservative administration.

The UK electricity supply industry reforms are examined by T. McDaniel in her paper "Deregulation of the UK Electricity Supply

Industry." The restructuring of the industry led to the introduction of competition through unbundling the four interrelated activities: generation; transmission; distribution; and supply. Significantly, it is believed that economies of scale are no longer sufficient to discourage entry in generation and supply of electricity. As a case study the UK is especially interesting because it comprises three different markets: England & Wales, Scotland and Northern Ireland, with respect to size, market structure, and timing of reforms. She concludes that most consumers have seen real price savings from the restructuring which has taken place so far and it is likely that further benefits will be forthcoming as supply competition unfolds and customers take fuller advantage of the opportunities afforded by competition.

S. Mani analyses the deregulation processes in the Indian manufacturing industry which began in 1991 in his paper "A Survey of Deregulation in Indian Industry." To date none of the 240 enterprises owned by the central government have been fully privatized. Railways and telecommunications are the sole monopoly of the central government. In electricity the central government owns the National Thermal Power Corporation and the North Eastern Hydroelectric Corporation, but the rest of the assets are largely owned by local (state) governments. He focuses on five dimensions: growth performance, structure, foreign investment, technology aspects, and SOE reforms. He concludes that the reform package has failed to revitalize the manufacturing sector as a whole though specific segments of it have exhibited brief spells of dynamism. The main problem with the reform process has been the ad hoc and unstructured nature of its implementation. Another concern is that regional concentration is bound to increase because emphasis in state-level implementation differs.

In his paper "Deregulation and Reforms in India's Telecommunications Industry," S. Mani analyzes the Indian telecommunications sector which has two components: manufacturing of telecommunications equipment and distribution of telecommunications services. In India the government regulated both these segments rather heavily. Deregulation of the equipment sector took place as early as the mid-1980s when the manufacture of many customer premises or terminal equipment were opened up to the private sector. But deregulation of the services segment occurred later in 1994 with the announcement of the 'National Telecommunications Policy.' He points out that reform in the services segment has been more effective in value added services such as e-mail than in basic services and that the monopoly of the Department of Telecommunications remains as strong as ever.

The US team's papers are presented in PART III. S. Berg gives us a brief overview of the US experience in regulation and deregulation in his report "Experience in US Regulation and Deregulation." The federal system has meant jurisdictional disputes, but the 50 states have also provided laboratories for experimenting with different types of incentives and industry structures. He draws six lessons for nations exploring alternative institutional mechanisms for addressing infrastructure industries. (i) Restructuring is inevitable, due to changes in technology and evidence that deregulation improves performance where monopolies are no longer least-cost suppliers. (ii) Agencies implementing policy change must maintain a delicate balance between commitment and flexibility. (iii) New configurations of firms and services cannot be predicted in advance, yet they characterize market processes. (iv) In creating regulatory agencies, governments need to establish independence, transparency, legitimacy, and credibility. (v) To ensure strong sector performance, agencies responsible for sector oversight must implement incentive schemes that promote efficiency and introduce competition where feasible. Finally, (vi) Governments must decide the market model and basic regulatory rules before privatizing.

In his paper "Lessons in US Electricity Market Reform," S. Berg examines the evolution of US energy policy, especially, electricity. He points out that compared with the past, production efficiency and improved price signals have taken on more importance relative to fairness as public policy objectives. He is certain that continued vertical disintegration and partial deregulation are inevitable in large systems or where technological change alters the existing scale economies.

T. McCoy presents a regional overview of reform in Latin America in his paper "Economic Stabilization and Liberalization in Latin America: Is the Reform Agenda Still Viable?" The governments of Latin America have pursued comprehensive economic reform over the past decade. According to him, the first wave of reforms is sometimes referred to the 'Washington consensus' which includes: fiscal discipline, reordered public spending, trade liberalization, privatization, financial market liberalization, exchange rate reform, tax reform, and deregulation. Second and third generation reforms focus on the following measures: labor market liberalization, social security privatization, new regulatory regimes, judicial reform, and education. He picks up eight lessons both good and bad from Latin American experiences. An example of a bad one is that the array of measures have not significantly reduced either poverty or income inequality.

L. Gutierrez and S. Berg study the determinants of telephone lines per capita using economic and institutional variables in their paper "Telecommunications Privatization and Deregulation: Lessons from Latin America." Explanatory variables include GDP per capita, the roles of openness (exports plus imports as a percentage of GDP), population density, institutional indices (the quality of the bureaucracy, economic freedom, and a sound regulatory framework), and the number of cellular phones per capita. They conclude that this empirical study sheds new light on the determinants of telecommunications investment in Latin America.

"Deregulation and Market Reform in Bolivia: A Grassroots Perspective" by L. Galindo and R. Godoy use probit regression analysis with a sample of 756 people interviewed to obtain information on citizens' perceptions for infrastructure reforms. Results suggest that no socioeconomic, demographic, or political variable emerged as a strong prime mover of support for the reforms across 10 sectors surveyed. Price increases lowered people's endorsement for the reforms, but perceived improvements in quality raised the amount of support for the reforms (but to a lower degree). In addition, for some sectors (e.g., electricity, railroads), political affiliation and knowledge of the regulatory agency increased the likelihood of endorsement, but for other sectors (e.g., airlines), nothing seemed to matter. In the short run, the government may need to explain with more care why prices have risen if it wishes to win broad-based support for the reforms across all sectors.

We believe that this is the first time that an outline of the overall picture of privatization and deregulation processes, which are underway in both advanced and developing countries, has been attempted. We hope that the wide country coverage of the book gives the reader a better ability to compare and understand what is going on now, especially, with regard to Asian countries such as Japan, Korea and India, which are important world players, but present a deep information gap with Western countries on the topics under consideration. Sector surveys in telecommunications and electricity also highlight the pros and cons of the privatization of SOEs. Forerunners in implementation of these processes such as the US and UK give latecomers useful policy lessons in terms of ownership, price setting (rate-of-return, price-cap, bench mark, yardstick, etc.), universal service, and welfare implications.

The above mentioned study results come from a joint-study on "Privatization, Deregulation and Institutional Framework," organized by the Institute of Developing Economies (IDE), JETRO, Japan with the participation of experts from the University of Cambridge, the United Nations University at Maastricht and the University of Florida in 1998. We owe much to the candid exchanges of opinions made during the international workshop on "Deregulation and Institutional Frameworks" held by IDE on December 7-8, 1998 in Tokyo. And particularly for the following papers which were presented at the workshop and were immensely helpful in the writing of the introduction and conclusion of this volume:

M. Pollitt, S. Mani, and T. McDaniel. "Summary of the UK Team."

S. Mani and M. Pollitt. "Lessons for India from the UK's Deregulation of Public Enterprises."

S. Berg, R. Godoy, and T. McCoy. "Overview of Regulatory Reform in the Americas."

M. Kagami. "Summary of the Japan Team."

Note

[1] Wimbledon effect or phenomenon derived from the fact that although Britain provides the world's famous arena for tennis at Wimbledon, the winners of the tournament tend to be non-British players. This in turn means that the liberalization of markets sometimes results in foreign capital dominance which actually occurred following the opening-up of financial markets in the City of London in the 1980s.