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Private Initiatives in Japan: Present, Problems, and Prospects

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1. INTRODUCTION

It becomes common to use the term “the lost decade” when we explain Japan’s business conditions in the 1990s, and monetary and financial policies taken by the government during the period are criticized in many papers and articles. Recognizing the UK’s success in introducing private initiatives (finance and know-how) in public works, the government of Japan started to promote the introduction of ‘Japan’s private finance initiatives (PFI)’ in 1997 in order to (1) recover the economy, (2) provide new business chances to the private sector (especially to general constructors), and (3) rationalize public business, enhance efficiency, and decrease budget expenditures.

Actually, local governments have set about selecting model projects and realized some of them, preceding discussions on Japan’s PFI Promotion Act (Act on Promotion of Public Infrastructure Development by Using Private Finance Initiative) in the Diet. However, some factors detracted from a satisfactorily smooth launching; differences in interpretation on PFI principles among ministries, sectionalism in the bureaucracy, and institutional defects derived from rigidity on behalf of both public and private sectors as they accept PFI concepts as a panacea for eco-

conomic recovery. In this paper, present conditions and problems surrounding private initiatives in Japan are examined: how the private and public sectors plan to introduce PFI and obstacles to realizing actual projects at present, etc. As with the case of the UK, the government has been faced with trial and error situations since it started the scheme, moreover in Japan, it seems to be difficult to set up a mega-project in a few years (for example, construction of a dam), based on private initiatives. However, institutional reforms on social infrastructure building and its defrayment are currently needed because local governments face financial difficulties in providing public services and finding necessary expenses.

The remainder of the paper will be organized as follows. Firstly, a review of how the introduction of PFI has been started by both the public and private sectors. In section 2, on-going and proposed projects are studied. In section 3, problems posed in introducing private initiatives of finance and know-how in public works are examined. The last section provides future prospects and concluding remarks.

2. STARTING PFI: THE PUBLIC AND PRIVATE SECTORS

2.1. Background

In Japan, local governments have partly entrusted public works to private enterprises, for example, collecting public charges, but in December 1996, the report by the Public Administration Reform Committee, "The Standards for the Ideal Stand of Public Administration," firstly and clearly expressed the necessity for the central government's positive commitment to private initiatives. In this report, three principles were proposed; (1) to maximize trusting public works to private enterprises, therefore, public commitments should be minimized, (2) to aim for effective public administration, and (3) to realize full accountability to the nation. The report indicated that reductions in tax revenues caused by the economic distress after the bursting of the bubble economy made the government look toward private initiatives to prevent public institutions and their expenditures from increasing in the midst of administrative reform.¹

Furthermore, in November 1997, the government decided to examine the possibility of introducing PFI into projects on social infrastructure building in "the Second Urgent Measures for National Economy." The measures established social infrastructure building as a new area for private investment. And in response to this development ministries and

local governments set up internal committees and study groups.

2.2. Activities by the Public Sector

At ministry level, the Ministry of International Trade and Industry (MITI) and the Ministry of Construction (MOC) were the first to start discussions on the introduction of PFI: MITI set up the 'Study Group on Private-Initiated Infrastructure Building' in October 1997, the MOC set up the 'Committee on Social Infrastructure Building Encouraging Private Investments' in November 1997. About one year later, the Economic Planning Agency (EPA) established the 'PFI Promotion Committee.'

Each of them released intermediate/final reports by the second half of 1999: In May 1998, the MOC committee made its intermediate report classifying types of PFI, and decided to support financially (e.g., subsidies) all the projects in principle. The MITI study group released its intermediate report indicating that the ministry puts importance on supportive measures (e.g., tax incentives, loans with low interest rates, and providing sites for projects, etc.), and on introducing PFI schemes as closely related to those in the UK as possible. The EPA committee completed discussions with its final report released in August 1999, showing how to operate the PFI Promotion Act. On the other hand, the Prime Minister's Office established the PFI Promotion Office and made a brief note to inform abstracts (e.g., the total budgets, project durations, brief contents and purposes, etc.) of seven model projects identified by the Office (see Table 3.1 to 3.3).

As apparent from the above description, no unified concepts or procedures are established for introducing PFI schemes among ministries. Although the PFI Promotion Office in the PM's Office is expected to become the core organization to bear the function of collecting and releasing information as well as providing the general schemes and procedures to the whole public sector as the Treasury Taskforce does in the UK, it cannot be said that the office has reached the anticipated level.

Local governments also established internal committees or study groups, and have already started to organize 'PFI projects' (Some are not categorized in PFI model projects depending on each ministry's standard.) based on their necessities and backgrounds. As some of the actual projects are examined in the next section, the table below lists other projects considered or being conducted (see Table 3.4).

Table 3.1: Promoting PFI at the Ministry Level

Name of Ministry	Month/ Year	Reports, etc.	Contents
Ministry of International Trade and Industry	Oct. 1997	<ul style="list-style-type: none"> establishment of the study group 	<ul style="list-style-type: none"> to introduce PFI in the form as close to 5 that in the UK as possible attach great importance on supportive measures to the private sector form the public sector (tax incentives, loans with lower interest, arrange of land, etc.)
	June. 1998	<ul style="list-style-type: none"> the interval report by the study group 	
Ministry of Construction	Nov. 1997	<ul style="list-style-type: none"> establishment of the internal committee 	<ul style="list-style-type: none"> to provide public supports (e.g., subsidies) to all PFI projects
	May. 1998	<ul style="list-style-type: none"> the interval report by the committee 	
Economic Planning Agency	Sept. 1998	<ul style="list-style-type: none"> establishment of the committee 	<ul style="list-style-type: none"> to explain the procedures of PFI projects (no major changes from the interval report)
	Jan. 1999	<ul style="list-style-type: none"> the interval report by the committee 	
	Aug. 1999	<ul style="list-style-type: none"> the final report by the committee 	
		<ul style="list-style-type: none"> establishment of the PFI Promotion Office 	
Prime Minister's Office	Jan. 1999	<ul style="list-style-type: none"> release of contents of model projects 	<ul style="list-style-type: none"> to provide some information (cost, period of the project, contents, etc.) on model projects

Table 3.2: PFI Types by the MOC Committee

Type 1	Charging Fees	<ul style="list-style-type: none"> • The project firm collects construction and management costs by charging fees or raising income from the concerning business. • The same as that in the UK except for supplement of lack of income.
Type 2	Joint Construction	<ul style="list-style-type: none"> • Both public and private facilities are jointly constructed. • Efficiency is expected to be improved, with public expenses decreased. • Original in this categorization (no similar type in the UK).
Type 3	Purchasing Public Service	<ul style="list-style-type: none"> • The private firms construct, manage, and operate the facilities instead of the public sector. • The same as that in the UK except for public supporting measures.

Table 3.3: PFI Types by the MITI Committee

Type 1	Self-Supporting Accounting	<ul style="list-style-type: none"> • The same as "Charging fees" by the MOC.
Type 2	Providing Public Service	<ul style="list-style-type: none"> • The same as "Purchasing public service" by the MOC.
Type 3	Cooperation between Public and Private	<ul style="list-style-type: none"> • Both the public and private invest in building and managing the facilities.

2.3. The Private Sector Preparing for Entry to PFI Business

Planning (design), constructing, financing, and operating are the main phases in the PFI scheme. Each field will be borne solely/jointly to think tanks (consultant firms), constructors, financial institutions, and trading companies.

Japanese general constructors are regarded as the biggest beneficiaries of introducing the PFI scheme, supported by countermeasures taken by the central government to stimulate the prolonged recession. The industry estimates that the domestic 'PFI market' will expand to the 1-trillion-yen level in five years, and expects the market to contribute to improvement and recover of their balance sheets, and to be favorable as

Table 3.4: Other Projects under Consideration by the Local Governments and Business Associations

Name of the Public Sector, etc.	Project	Contents	Type
Fuji-Yosida City	Construction and rearrangement of municipal hospital(s)	Construction of new municipal hospital(s)	Providing (Purchasing) Public Services ?
Fukuoka Pref., Yamaguchi Pref. & Kyushu-Yamaguchi Business Association	The Naruto Channel Road Project	Constructing the bridge and road to connect the Kyushu and San-in areas	Charging Fees ?
Iwate Pref.	Development of the public estate in the west area of the Morioka Station	Construction, management, and operation of public facilities	Providing (Purchasing) Public Services ?
Keidanren	Re-development of the Central Tokyo Aea	Construction of underground highways around the Yamanote Line, high-rise residents, etc.	Joint Construction ?
Kumagaya City & Saitama Pref.	Techno-Green Center Project	Constructing facilities for both public and private use	Joint Construction + Providing (Purchasing) Public Services ?
Shizuoka Pref.	Maintenance of facilities in the Shizuoka Airport	Reform and management of the existing facilities	Providing (Purchasing) Public Services + Charging Fees ?
Utsunomiya City	Re-development of the east area of the Utsunomiya Station	Both public and private sector jointly organize the urban planning	Joint Construction ?

Source: <http://xing.mri.co.jp/region/RC05/toku01-g.html>, the note released by the PM's Office on the PFI model projects, etc.

a new business field for investment. Accelerating establishment of internal institutions and making alliances with consultant firms and/or companies in other business fields to participate in domestic/foreign projects, some of them have already offered many proposals to the public sector based on their abundant experiences in BOT projects abroad. In addition, some corporations (e.g., Nishimatsu Corporation and Kajima Corporation) have been appointed as a project contractor jointly with domestic firms in the UK's PFI projects² to internally accumulate necessary knowledge in preparation for the spread of PFI in Japan. On the other hand, big constructors' network-building for realization of PFI projects in Japan is already in process. For example, Taisei Corporation allocates specialized staff to divisions of construction and engineering businesses, and administration, with an internally coordinated system. Other general constructors also allocate 'PFI specialists' to their branches and have finished arranging a system to collect information on public sector commitments.

Meanwhile, general trading companies aim to secure the long-term resources of investment and financing by participating in PFI projects. Their ability to access large funds and purchase a wide range of materials and know-how to organize consortiums will be invaluable when large-scaled projects are realized. Moreover, as they have abundant experience in accepting and surveying plant projects abroad, they have played the leading role in arranging projects, especially in the areas of collecting information, negotiating finance, procuring materials, managing risks, etc. Above all, their core function derives from their comparative advantage in financing large amounts of funds, and here their credibility exceeds companies in other fields. In recent plant projects, accepting firms should be responsible for managing and operating as well as constructing the facilities, therefore, their experience will be applied to PFI projects in Japan (Some of them have participated in UK projects). The interest of trading companies in PFI projects in Japan seems to focus on the environment business and they have pushed those kinds of projects to local governments, jointly with plant-makers with original technologies, such as power generation based on waste management.

Financial institutions, especially banks, have consigned project financing and syndicated loans in plant projects abroad. Similar to trading companies, their comparative advantage is in organizing financial schemes for large projects. In addition, some city banks cooperate with think tanks in making advisory contracts prior to planning or screening

projects by coordinating staff in research and business divisions. Influenced by those activities, the equity and bond markets (the Tokyo and Osaka Stock Exchanges) announced in September 1999, that they had plans to establish a 'PFI market,' where stocks and bonds issued by project companies are circulated, to invite various investors into the PFI business.³

Furthermore, companies began to organize study groups among themselves and business associations held meetings and approached the national/local governments to set up large-scaled projects aiming to promote the PFI business in an ideal way. For example, in September 1999, the Japan PFI Association, a nonprofit organization, was set up with 21 private companies. The Association allows local governments membership and anticipates at least 120 member companies by the end of August 2000. Its main aims are to build a nationwide 'PFI network' and to establish correspondence courses for local public officials, in order to deepen understanding and knowledge on ways and procedures of PFI projects.

3. MODEL PROJECTS OF PRIVATE INITIATIVES IN JAPAN

Private initiatives in public works are mostly 'under consideration' at present by both prefectural and municipal governments, partly because most of them have just finished research activities to understand 'what is PFI.' Therefore, they are still prudent to its introduction. As stated in the previous section, they started to set up internal committees and/or conduct research on selecting possible projects around 1998. According to the PFI Promotion Act, it is generally recognized that the difference between PFI and joint construction projects relies on 'private initiative,' which means the private sector should play the leading role in designing (planning), building and managing the projects. However, confusion and nonunified categorization of 'what is Japan's PFI' among ministries has sometimes led inappropriate models to be assorted in PFI. In the present circumstances, the forms of participation of the private sector in public works are as follows:

- (1) Joint construction: The private and public sectors cooperate in building the core facilities of the project, and jointly/separately own them.
- (2) Management by the private sector: The public sector constructs

the facilities, and the private sector manages them.

- (3) The third sector:⁴ The public and private sectors jointly contribute in and operate the project.
- (4) PFI: The public sector selects the projects, and the private sector offers, finances, and provides know-how in building/managing/operating public services.

Based on the above categorization, 'PFI' projects at present are classified and examined. However, model projects for category (2), for example, packaged entrusting maintenance and operation of public amusement facilities, parking lots, and/or educational facilities (public schools and libraries), etc., is deleted below since an actual project has not appeared yet, rather it has been speculated that some local governments might consider it possible.

3.1. Joint Construction (Cooperation between Public/Private)

3.1.1. The Chubu International Airport Project (Aichi Pref.)

Under the MOC's plan to consolidate international hub airports, the Chubu International Airport (CIA) is to start operation in 2005, as the nation's third international airport following Narita and Osaka Airports. The objective of constructing the CIA is to provide transportation measures for the Aichi Exhibition to be held in March 2005. However, the possibility of delay of its opening has been reported because of financial problems (e.g., the cost of reclaiming work is expected to be more expensive). The constructor, Chubu International Airport Co. Ltd., is an authorized firm jointly invested by the central government, local governments, and private enterprises (including local financial institutions) with a ratio of 4:1:5, and MOC identifies this project as the first PFI model under the ministry's administration.

However, the project should be regarded as Type (1) according to the following two reasons. Firstly, responsibilities of the private sector and local governments (17% for each) in the total cost of construction (¥768 billion, 40% of which is provided by loans without interest) are relatively small, contrary to that of the central government (66%). Additionally, through issuing government-guaranteed bonds by the CIA Co. Ltd., the Treasury Investment and Loans has financed the project since FY98 (for this fiscal year, ¥285 billion). From the financial side, the CIA project is typically 'public-led.' Secondly, when they started the CIA project, they

did not take the procedure of public bidding. Consequently, other private firms or joint ventures could not have any chance to offer project plans. The CIA Co. Ltd. publicly released only the establishment of the corporation and the allocation of managerial posts among contributors based on the ratio of their contribution. In this aspect, it should be said that they did not take the basic procedures in PFI schemes; a public notice of projects, offers concerning profit-making business by private firms, examining those offers by the public sector, etc.

On the other hand, they introduced the public offering for contracts on advisory service and procurement of equipment after the CIA Co. Ltd. was established. By contrast to the open bidding system which had formerly been used in big public-work projects, it has been difficult to (1) consider factors other than bidding prices, for example, technologies and punctuality of delivery dates, and (2) to widely invite applicant firms including foreign/foreign-capital firms. The use of public offering is done to avoid the possibilities of *ex ante* arrangements among applicant firms, but general constructors and local enterprises which participated in the public offerings in the project have pointed out that disclosure concerning the process of selecting the contracting party and the bid price were not released promptly and properly.⁵

3.2. The Third Sector (Joint Contribution)

In the 1980s, many third sector companies were established with joint contributions by the central/local governments and private firms to operate local development and urban planning. At the time of their establishment, those companies were regarded as an innovative measure to attract private sector funds and know-how to projects with the characteristics of public benefit, not aiming only at short-term profitability as well as to improve local economies. However, most of them now suffer from managerial distress and large deficits, so the central and local governments have been forced to provide additional financial support, such as making up for losses, loan rescheduling, and decreasing interests, etc.⁶

Nonetheless, some local governments have recently considered to establish a kind of 'new third sector company' by introducing the principles of PFI. Here, they try to resolve defects of the third sector schemes in the 1980s, for example, ambiguity of risk allocation, lack of sense of cost-performance, *ex ante* arrangements of bankruptcy operation, and conditions of dissolution.

3.2.1. *General Waste Disposal Site for Four Cities (Chiba Pref.)*

Kazusa Clean System Co. Ltd. (KCS) was established as a third sector firm (contributed by the four municipal governments listed below, Shin-Nihon Steel Co. (SNS), Emco Co., and Ichikawa Kankyo Engineering Co.) in December 1998, to build the first waste disposal site managed and operated by private initiative, with the area for its operation expanding to four cities; Kisarazu, Kimitsu, Futtsu, and Sodegaura. This was the result of a two-year examination by local governments and three private enterprises started in 1996, and the decision to realize the project was announced in September 1998.

The reason for starting this project was that each municipal government was forced to find new refuse treatment facilities. In Kimitsu City, an ironworks of SNS needed a new disposal site in addition to the fact that the municipal government had entrusted total waste management of incombustibles and ashes to private firms within and outside its administrative area, and the capacity was exhausted. In Futtsu and Sodegaura, their present sites are close to the limits for reconstruction or specification dates. Furthermore, the administrative operation for waste management expands to a wide range of fields; decreasing of waste by recycling, promoting recycling business through separated collections and intermediate operations, securing proper management in the case of incinerating, and decreasing costs for the business, etc. Therefore, it was necessary to expand the administrative area to satisfactorily manage the whole refuse treatment operation.

One of the characteristics of this project is that KCS, as a third sector firm, seeks effective management by introducing the PFI method and technologies/facilities of the private sector to secure the public sector's responsibilities regulated in the Waste Disposal and Public Cleansing Law. Another is Shin-Nihon Steel's (one of the contributors of KCS) original technology with which waste has been gasified and smelted at high temperatures safely for 20 years. With the technology, they are able to recycle materials instead of incinerating and reclaiming waste and are expected to cope with dioxin and resource recycling problems.

KCS attaches importance to business continuity and stability therefore risks and responsibilities taken by the public and private sectors are clearly defined. They are written in the shareholders' agreement and the consignment agreement: (1) the four municipal governments are responsible for collecting/disposing of waste and have accountability to resi-

dents, (2) SNS is to construct and operate the facility and support finance and its negotiation, (3) Emco Co. and Ichikawa Kankyo Engineering Co. are to provide managerial know-how concerning the waste management business. In addition, the four governments set up liability burdens of 20 years from 2001 in the consignment agreement to entrust waste management to KCC, on the contrary, KCC would adopt project financing in which contributor firms do not support or guarantee its loan retirement, in consideration that its income resource is a part of tax revenue.

3.2.2. *Refuse-Derived Fuel Electricity Project (Fukuoka Pref.)*

A third sector firm named Ohmuta Recycled Power Generation Co. Ltd. (ORPG) was established in January 1999, contributed by Fukuoka Prefecture, municipal governments, local financial institutions, and Electric Power Development Co. Ltd. (EPDC),⁷ to set up an electric power business using only refuse-derived fuel (RDF) out of general waste.

In this 15-year project starting in 2002 with the total budget of ¥7 billion, ORPG will build, manage and operate a waste disposal site and power plant; to solidify 240 tones of general waste a day, generate 13,400kW a day with RDF, and raise income by providing solidified ashes to recycling business firms and electricity to Kyushu Electric Co. according to the menu for purchasing waste surplus. Similar to the project in the above sub-section, this project is one of the model cases introduced by the PFI Promotion Office in the Prime Minister's Office. However, this project should not be categorized in PFI for the following reasons: Firstly, this project was originally started when the Fukuoka prefecture government entrusted a research project for electric power generation with refuse incineration to EPDC in FY95-96 (directly after EPDC had completed the research, the Ohmuta municipal government participated in discussions to realize the project). Accordingly, no offers by other private firms or public bidding were organized. Secondly, some ambiguity remains at the stage of financing of construction/operation costs. As seen in the KCC project, the use of project financing shows that contributing companies provide no credit guarantees to the contract enterprise, but in this case, details of loans to be provided by local financial institutions to ORPG, in addition to subsidies from the public sector and loans from the Development Bank of Japan, are not clarified, i.e., whether they are based on an analysis of ORPG's cash flow.

On the other hand, burden sharing between the public and private sectors are stated. In the Waste Disposal and Public Clearing Law, waste management is classified as the municipal governments' responsibility, and the total budget of the operations is estimated to exceed some trillion yen at the level of all municipal governments. Its wide range of operations is regarded as a kind of burden from municipal governments, but the 'market' seems very attractive to private firms with appropriate know-how and technologies. If they can secure the scale merit by the local governments' effort to out their administrative areas together, it becomes much easier to start the business as a PFI project,⁸ since one of the characteristics of projects for waste management and construction of its facilities is that the future demand and the business scale is comparatively easy to estimate from past data. In a few years, many plans at the municipal level will be realized with the electricity providing market (deregulation is processing in this area) in sight.

3.3. Public Works with Private Initiatives (PFI)

As described above, the number of on-going projects based on the principles of PFI is still small. Furthermore, some of them have been recently re-planned by switching from the use of third sector schemes (for example, see 3.3.2 in this section) since the schemes have been under criticism concerning debt accumulation since the mid-1990s. Despite that, the examples below can be considered as the PFI model at least from the viewpoint of procedures taken.

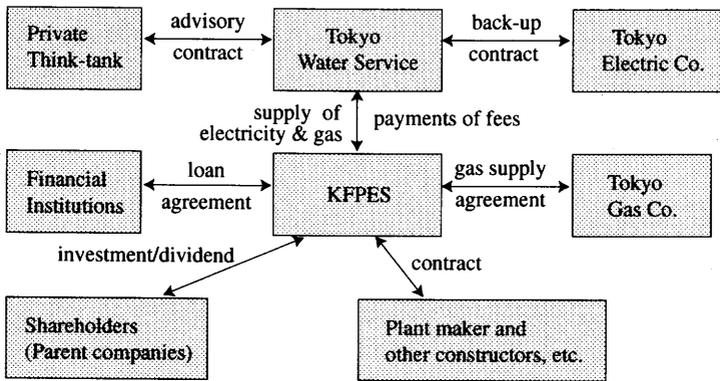
3.3.1. Cogeneration Power Plant for Kanamachi Filtration Plant (Tokyo)

Tokyo Water Service (TWS) is the first public sector that adopted PFI in its business, and this project is a model case in the general commitment to PFI in Japan. This 20-year project is categorized in the 'service purchasing' type with BOO (Build-Own-Operate) scheme: a self-financed company will build, own, and operate a regular power plant in the filtration plant to supply electricity and steam to TWS to be used as power and thermal resources of the filtration plant. The project company will cover the operational expenses with the fees paid by TWS, recollecting the cost of construction and facility investment, and finally it should remove the power plant and recover the original condition.

The reason TWS plans to equip a regular power plant is, firstly, to take countermeasures to cope with earthquakes and pay due consideration to the environment. Facilitating the cogeneration system to provide electricity resources in case of earthquakes at the same time contributes to the urban planning with resource circulated. TWS decided to introduce the PFI schemes in August 1998, as a result of broad examination of many factors; profitability and risks of the project, concerning laws, properness of the business scale, and finance resources, etc. And the other reason is the financial difficulty to bear all the costs when many facilities have to be maintained and/or equipped in a certain period, as TWS indicated the possibility to adopt the model scheme to other filtration plants (the Asaka, Misato, and Misono plants).

Prior to the public offering of the project in January 1999, TWS conducted an advisory contract with a private think tank in December 1998. The contents of the contract are as follows: (1) 'advice to the project management' to set the whole scheme for the business, (2) 'advice to the financing and profitability' to the private counterpart, (3) 'advice concerning legal procedures,' (4) 'advice concerning technologies' to examine credibility and advantages. Also, TWS set up the Judging Committee for Proposals on PFI Model Project of Regular Power Plant in Kanamachi Filtration Plant to select the best project firm securing fairness, transparency, and objectiveness. The public bidding was conducted in two-fold, and in November 1999, TWS formally contracted with Kanamachi Filtering Plant Energy Service Co. (KFPES, a special-purpose company contributed by Ishikawajima-Harima Heavy Industry, Shimizu Corporation, and EPDC).

For financing of the project, the Development Bank of Japan⁹ and Daiichi Kangyo Bank (DKB), as co-lead managers, decided to provide loans amounting to ¥1 billion, examining only the cash flow and profitability of KFPES.¹⁰ In this project, the power plant is to be constructed on the property of the Tokyo Metropolis, therefore, financial institutions cannot affect the security right on the site. DKB said that they would apply this scheme to other PFI plans, and some development in the financial aspects can be expected as cases are accumulated (see Figure 3.1).

Figure 3.1: Business Scheme of the Kanamachi Project

Source: http://www.waterworks.metro.tokyo.jp/pfi/pfi_1.htm and Tokyo Waterworks [1999], p. 3.

3.3.2 Higashi-Kishu Communication Base Project (Mie Pref.)

The Mie prefectural government is known as a progressive public sector, conducting the new administrative system, which evaluates 3,381 operations by the government, based on the principle to enhance the residents' satisfaction. And the government has entrusted research on regional development to private think tanks according to the new administrative system.

The Higashi-Kishu Communication Base Project is included in the regional development plans, which aims to construct an information center in Kii-Nagashima, facilities using deep water in Washio city, and a recreation and sport center in Yuya city, etc., by means of PFI (the scale and total budget of the project is the largest at present). The basic concept of this project is to introduce the superior techniques and know-how of the private sector. The prefectural government formerly planned to realize the project as a third sector scheme but decided to shift to PFI schemes according to the result of their operation evaluations.

The procedures of the public offering were two-fold: Firstly, in July 1998, the government invited private firms to be trustee(s) of research on the projects' possibility of introducing private initiatives and contracted with two companies (NKK for the Kihoku (the north part of the prefecture) area, and Mizuno Co. for the Kinan (the south part) area), considering the characteristics of the facilities. The research was conducted till

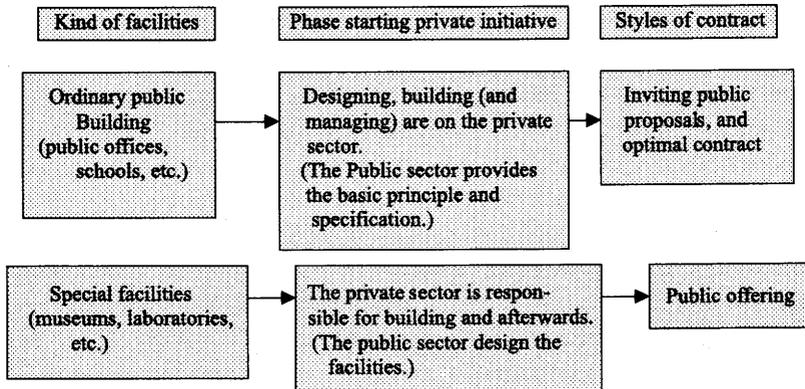
March 1999. Secondly, bidding on the project firm is to be conducted by the end of the FY99, after arranging conditions on risk-allocation and financing, etc.

3.3.3. Kanagawa Scheme (Kanagawa Pref.)

Financial conditions of the Kanagawa prefectural government have been very severe and expectations for improving them are scarce.¹¹ Therefore, the government introduced the 'Kanagawa Scheme,' similar to the BLT (build, lease, and transfer) or BTO (build, transfer, and operate) scheme, since FY98 to maintain and promote public services by means of private initiatives (see Figure 3.2). They seek to facilitate a new hygiene laboratory, the annex building of the Museum of Modern Art, and a prefectural university, etc., entrusting their construction, management, and operation to the private sector. The benefits of this scheme are: (1) the government can suppress the temporary expenses of construction, or equalize the expenditures of each fiscal year, (2) lease fees can be comparatively low by verifying the project terms according to characteristics of facilities.

Although the detailed information on schedules of public biddings has not been released, formation of probable schemes which can be applied to other public sectors suffering financial difficulties are to be expected.

Figure 3.2: The Kanagawa Scheme



4. PROBLEMS CONCERNING INTRODUCTION OF PFI

As the background to why PFI schemes recently gained attention in Japan, we can indicate (1) the possibility to stimulate economic conditions by promoting public works within the scope of the need for financial reforms, and (2) expectations of PFI schemes themselves as an alternative to third sector schemes with debt accumulation. However, problems concerning the introduction of PFI in Japan have arisen from the above two points because the concept of PFI as a countermeasure for economic stimulation and financial reforms are basically incompatible with each other, especially under the present PFI Promotion Act that offers a series of supportive measures by the central/local governments. In the following sub-sections, those problems are examined from the points of (1) social problems, (2) legal problems, and (3) administrative problems.

4.1. Problems in the Social Aspect

- Necessity of the preparation and arrangements to transfer to the contract-based society: As apparent from the failure of third sector schemes in the 1980s, introducing the concepts and disciplines of contract is inevitable when PFI projects are operated. For this purpose, both the private and public sectors should fully examine how to allocate the risks and responsibilities concerning the project. Also, nurturing experts such as lawyers and establishing some qualification system for management consultants is needed in order to conduct procedures including public offerings smoothly.
- Lack of the knowledge accumulation: The former general open bidding system has not provided a deep enough knowledge on law, managerial techniques, and especially financing to the public sector. In PFI schemes, both the public and private participants are forced to conduct in-depth negotiations thoroughly on the project. As already tried in the TWS project, the public side may make advisory contracts or set up internal education systems to promote the necessary knowledge and foster the view of total management.

4.2. Problems in the Legal Aspect¹²

- The main field of former and present public works has been con-

cerned with construction, therefore, in the articles of the PFI Promotion Act, the viewpoints of service purchasing from the private enterprises and entrusting managerial functions to them are less influential.

- Laws, acts, and systems concerned should be revised, for example on property tax, urban planning tax, and accounting systems, etc., to enable the necessary procedures in the project to be conducted smoothly.
- In the PFI Promotion Act, a lot of measures to provide public support to the private counterpart are listed. Until a common scheme or standard is established, those measures may cause moral hazard of contract enterprises.

On the other hand, the fact that objective selection by public offering (Articles 6 and 7) and descriptions on the importance of deregulation and the lifting of unnecessary regulations (Article 20) are expressly stated in the law should be welcome. Although progress in whether these statements are promoted needs to be closely watched, the statements are effective in securing procedural transparency.

4.3. Problems in the Administrative Structure

- **Budgeting Structure:** It is doubtful whether the actual necessity of the designated projects (or facilities) is really examined by the public sector. Local governments should avoid easily planning projects to construct buildings by the PFI schemes, because at present, the expectation that PFI might eliminate financial burdens of the public sector is excessively stressed.

On the other hand, it is not negligible that the present structure for budgeting has required local governments to continuously plan new public works projects to acquire subsidies from the central government. Therefore, the tendency of local governments to easily replace third sector projects, which are under strong pressure from society because of the severe experience of the 1980s, with those under the PFI scheme partly arises, and the fact will be criticized as 'moral hazard on the side of the public sector' in distinguishing unnecessary projects from those necessary.

The usage of 'PFI' schemes will dramatically lessen the expenses of public works in the beginning, but actually, payments for the received service will continue during the whole period of the project

which means nothing but postponing payments of total expenses. PFI itself will not improve the financial conditions of the public sector. Some accounting systems to include the cost of PFI projects in the deficit side of the public sector's accounting are inevitable to clearly indicate how much they rely on the scheme.

- **Who leads PFI in Japan?:** The PFI Promotion Office in the Prime Minister's Office should take the leading role through discussions within the PFI Promotion Committee, in showing the whole public sector the necessary procedures and standards to introduce PFI schemes in public works, also to avoid the possibility of conducting unnecessary or inefficient projects by local governments without prudent screening. In addition, the tendency described above is partly caused by the present situation where no unified standard to introduce a scheme as well as to operate and evaluate a project has been shown at the level of the central government. It can be said that some projects with this tendency are recognized as PFI models at ministry-level against the intention of central government to simultaneously realize private initiatives and economic recovery by the expansion of public works.

On the other hand, the lack of unified standards reveals that no organization has the authority and responsibility to suspend/reject projects based on the cost-benefit analysis and the concept of 'Value for Money' when those which are inappropriate are offered. In the UK, the Treasury Taskforce has this authority and some projects have been suspended in the past. Although the PFI Promotion Act offers various public support, no countermeasure to secure the effectiveness in operating public works is described in the Act. The PFI Promotion Committee established according to the Act¹³ has held meetings since October 1999, but discussions on whether the Committee operates with that kind of authority or how it controls PFI-related offices in other ministries have not been conducted yet. It will take more than one-year before the whole public sector is able to evaluate PFI projects under a certain standard.

- **Who finances public works?:** Revision of the present procurement of financial resources for public works needs to be enhanced and promoted. In the present system, projects are financed by public bonds and subsidies from the central government, and local governments need MOF's permission when they issue public bonds. However, once they get permissions, it means that the necessary

financing is completed because the bond is to be accepted by the Treasury Investment and Loans. Therefore, under this kind of system, incentives for local governments to reduce expenditures and reform their financial conditions naturally become weak. The central government intends to lift the permission system for public bond issuing and introduce the ex ante discussion system in 2006, and after its completion, the local governments' responsibility and discretion in public works financing will be greatly enlarged.¹⁴ Accordingly, some critics and academics point out that the PFI schemes will not be generalized until FY2005, but the private sector is already looking for new business chances.

5. CONCLUSIONS

PFI projects in Japan are still at the starting point. As with the UK where repeated trial and error was seen in formulating the scheme, many changes and failures are anticipated before establishment of the basic procedures for private initiatives are realized in this country. According to the examinations described in the above sections, we can indicate the following points.

Firstly, local governments will start with projects adopting PFI schemes on a comparatively small scale, and then, begin to organize larger projects. Although the public side should pay due consideration to the criticism that public works have the tendency to prefer constructing buildings (*hakomono*, in Japanese) such as museums, halls, and convention centers, etc. (see the sub-section above), as seen in the Kanagawa scheme, if the facility is relatively small like a laboratory or an annex of a museum, the public sector can easily advance the necessary procedures and evaluate whether the management and operations by the private sector are appropriately conducted, by eliminating to a certain object facility.

Secondly, contrary to the first one, local governments will come to jointly organize projects putting their administrative areas together in some specified fields of public services, such as waste management and maintenance of educational facilities like schools, because some of the public operations need to make joint contracts especially for small local governments to operate appropriately and efficiently.

Thirdly, efficiency of public service operations is expected to gradually improve by introducing PFI schemes. Some local governments began to make advisory contracts with consultant firms even for conducting the

former-styled public works and decreased expenses, recognizing the importance of cost-benefit analysis in the course of selecting designated PFI projects. In PFI schemes, each participant's (i.e., the public sector, offering firms, consultant firms, etc.) know-how in the fields of their comparative advantages should be effectively combined at the stage of project planning, and that means that advancement of managerial ability on the public side is unavoidable.

Finally and to realize the third point, the expressed and unified principles and procedures of PFI according to its categories should be shared among ministries. At present, PFI in Japan is at the stage of 'test working,' and the institutional arrangements lag far behind the real operations by local governments. As repeatedly stated in this paper, the PM's Office, especially the PFI Promotion Committee should release the principles of application and the evaluation system to the administrative organizations.

As the model projects are accumulated, to find new problems and ways to improve is the future subject, based on analyzing data on improvement/decline in efficiency and service quality, changes in forms of ownership of facilities formerly considered 'public,' and so on. In the UK, it took nearly 10 years before the amount of the contracted PFI projects exceeded 10% of total public work expenditure since Mr. Major declared his idea to manipulate private funds for public works. Financial conditions in Japan's central and local governments are very severe. If the central government does not revise related laws/acts and promote deregulation in the right order, it will take much longer to establish PFI schemes in this country.

Notes

The author thanks to Ass. Prof. Naoto Yamauchi (Osaka University) for his useful comments, and to Mr. Osamu Ikeda (NJS E&M Co., Ltd.) and Mr. Toru Nakagawa (Japan International Cooperation Agency) for instrumental suggestions and information.

¹ The government of Japan suspended to promote public administration reform to settle the non-performing loan problems in the financial sector in 1998.

² Kajima Co. participates in a PFI project to rebuild offices of the UK government (four-billion-yen, 30 year) jointly with a UK-based home developer (*Nihon Keizai Shimubun*, 19 April 1999). According to Mitsui Trading Co.

[1999], Nishimatsu Co. established a joint-venture company with the UK Mitsui Trading Co. and John Mowlem Co. (a UK-based construction firm) to assign the tunnel project involved in the Dogruns Light Railway Louisham Extension Project.

³ Concerning the PFI equity/bond market, the JAPIC's (Japan Project-Industry Council) report indicates four points; (1) at present, corporate bonds for the long-term investment are forced to acquire high classifications, (2) it is difficult to invite institutional investors before the PFI markets are established, (3) disclosure concerning the projects are inevitable, and (4) efforts to attract personal investors are needed (*Nihon Kensetsu Kogyo Shimbun* (The Daily Engineering and Construction News), 18 January, 2000).

⁴ The third sector (a joint-venture enterprise contributed by the public and private sector) scheme is sometimes considered as a pattern of 'Public-Private Partnership,' but, as described below in the text, it lacks (1) risk allocation between contributors, (2) clarified distribution of responsibilities, and (3) contracts concerning procedures taken in the case of bankruptcy. Therefore, in this paper, this scheme is excluded from the category of 'private initiative.'

⁵ *Nikkan Kogyo Shimbun*, 19 August, 1998.

⁶ According to the survey of local governments conducted by *Nihon Keizai Shimbun* in November-December 1997, 19.3% of the total municipal and prefectural governments had third sector companies actually going bankruptcy (at the level of prefecture, the rate goes up to 46.8%, and that of ordinance-designed city hikes up to 88.3%). The other *Nihon Keizai Shimbun*'s survey of the third sector firms showed that 70% of them had debt accumulation, and about a half of them could not prospect to settle down the problem. Concerning the boom-and-burst cycle of the third sector firms, see Kagami's paper (Chapter 2) in this volume.

⁷ Strictly speaking, EPDC, also participating in the Kanamachi filtration plant project, is not a private firm, but a special corporation under the control of MITI (contributed by the Ministry of Finance and nine electric power companies). According to the Cabinet's decision in June 1996 to completely privatize EPDC and list it in the Tokyo exchange market in 2002, the company rationalized its affiliated companies (decreasing 15 to 9 firms, finished in March 1999), and is strengthening its financial management (repayment of loans from the Treasury Investment and Loans; the firm aims to repay FIL loan to nil in 10 years after privatization, but since the FY 1998, it has been allowed to issue government-guarantee bonds instead of FIL loan).

⁸ Among nine municipals in the south Hokkaido prefecture, the same kind of private-initiative project is being examined, following the establishment of the Study Group for the Nishi-Iburi Regional Final Disposal Site. Some enterprise groups, trading companies, and producers of environmental equipments have already offered proposals.

- ⁹ DBJ (a new financial institution enacted in October 1999 with the merger of Japan Development Bank and Hokkaido-Tohoku Development Corporation) has began advisory business concerning PFI projects, also provides long-term loans (15 years at the longest) with fixed policy interests.
- ¹⁰ KFPEs and the two financial institutions have not formally contracted. Other banks may participate in the loan syndicate (*Nihon Keizai Shimbun*, 16 November 1999).
- ¹¹ Among prefecture and local governments which are tackling with financial reforms, Kanagawa and Osaka prefectures' situation is extremely serious, as the ratios of current expenses to current income of the two prefectures exceed 100%. Especially, the ratio of obligatory expenses to the total expenses of Kanagawa is the worst of all local governments, and the ratio is estimated to hike further. Although the Kanagawa government has tried crisis-prevention measures (e.g., suspension of reserve accumulation for repayments of public bonds, and sales of disused properties), the possibility to be identified as a reorganization body is still high. At the stage of budget compilation for the FY 1998 (totaled to ¥1,730 billion), the amount of financial resource shortage was about ¥170 billion, with the 256-billion remainder of public bond at the end of March 1998, therefore, it has become harder for the government to arrange construction/management/maintenance of new public facilities as well as that of present ones.
- ¹² For details, see Yamada's paper (Chapter 4) in this volume.
- ¹³ According to the Article 4 of the PFI Promotion Act, the Prime Minister should release the basic principles and the operational principles based on the discussion within the PFI Promotion Committee. It is divided in two subcommittees: one for the discussions on the operational aspects, and the other is for those on the evaluation aspects. Based on the minutes released on the homepage of the PM's Office, the Committee is now amid discussions on what the basic principles should be.
- ¹⁴ In advance to this reform, the Law of the Funds of the Trust Fund is to be revised in 2001. The revision will considerably eliminate accessibility to the postal savings for the resource of public investment, allowing the postal savings the self-investment.

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