

Chapter 2 From Public Sector to Private Sector – Restructuring of Government Sector and Associated Challenges

Section 1 Views on Small Government

- The size of government sector could have negative impact on economic activities.
- An analysis using the survey on the size of government sector suggests that limiting the size of government spending and tax burden through prioritizing its components could lead to the increase in utility.

[Analysis]

(Impact of government size on economic activities)

- Large government spending could have a negative impact on the economy as public sector inefficiency, taxation, and social insurance premiums could affect capital accumulation and the labor supply. Panel data estimates of OECD countries show that government spending has a negative impact on the economic growth rate.

Table 2-1-6 Size of government spending and economic performance

(a) Panel analysis by OECD data - shows negative impact on growth of large government spending
 Estimation method: Real GDP growth rate
 $=\alpha_1 + \beta_1(\text{gov. spending}) + \beta_2(\text{catch up rate}) + \beta_3(\text{degree of economic openness}) + \beta_4(\text{aging rate}) + \varepsilon_{i,t}$
 Catch-up rate: per capita real GDP, Degree of economic openness: Export and import / GDP

Dependent variables	Real GDP growth rate				Real GDP growth rate (moving average over prior three periods)		
	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6	Case 7
Government spending	-0.201* (-6.89)	-0.216* (-7.13)	-0.216* (-7.14)		-0.202* (-7.97)	-0.206* (-7.34)	-0.224* (-7.79)
Government consumption				-0.698* (-6.11)			
Formation of government fixed assets				0.019 (0.11)			
Catch up rate		-0.117* (-8.67)	-0.117* (-8.70)	-0.166* (-8.32)		-0.095* (-7.73)	-0.106* (-8.36)
Degree of openness		0.066* (6.03)	0.066* (6.04)	0.097* (6.59)		0.062* (6.52)	0.063* (6.51)
Aging rate			-0.059 (-1.49)	-0.006 (-0.08)			0.140 (1.48)
R ²	0.351	0.458	0.461	0.433	0.525	0.598	0.616
Sample number	420	420	420	365	364	364	356

- Notes: 1. Data is taken from *National Accounts*, OECD.
 2. The estimation period is from 1988 to 2003 for cases 1 to 4 and from 1988 to 2001 for cases 5 to 7.
 3. Figures within brackets show t-value. Figures with * are coefficients that are significant at a level of 1%.

(National awareness survey on the size of government)

- The Cabinet Office implemented a survey of 2,000 households around the country (response rate 56%). The survey asked respondents to look at various combinations of government spending and national contributions in a variety of breakdowns and to select the one that they found most appealing. Through this survey, it was possible to measure preferences concerning government spending and the willingness to bear the burden of government spending.
- Results show that among all respondents there was a willingness to permit a 0.24% increase in the national contribution ratio in return for a 1% increase in social security benefits, though this willingness was lower (0.15%) among younger respondents.

Table 2-1-12 Rate of willingness to pay for social security benefits

The rate for willingness to pay is low for people in their 20s and high for people in their 60s (Unit:%)

Total		0.24
Gender	Male	0.23
	Female	0.26
Age	20s	0.15
	30s	0.27
	40s	0.25
	50s	0.22
	60 and older	0.34

- Using the results from the above estimates, a simulation was conducted based on projections that the potential national contribution rate is kept to a level of around 50% in 2025. Specifically, the following three proposals were compared: 1) keeping national contribution rate to 50% by reducing social security benefits (policy proposal 1), 2) keeping national contribution rate to 50% through reductions in social security and public works projects (policy proposal 2), and 3) allowing the contribution rate to rise to 56% with no reforms (policy proposal 3). Given this comparison the policy proposal with the greatest deal of support was number 2—to reduce both social security and public works projects. In addition, the first proposal to reduce social security was popular among people in their 20s, showing the importance of responding to the generation gap in social security.

Table 2-1-14 Simulation of support rate for policy proposals to control potential national contribution rate

If the contribution rate is lowered by revising spending, utility increases

		Policy prop. 1	Policy prop. 2	Policy prop. 3
Social security benefits		25% reduction	15% reduction	Status quo
Public services		Status quo	Status quo	Status quo
Public works projects		Status quo	40% reduction	Status quo
Potential national contribution rate		50%	50%	56%
All responses		22%	55%	24%
Gender	Male	21%	58%	20%
	Female	22%	51%	27%
Age	20s	27%	49%	24%
	30s	20%	60%	20%
	40s	21%	58%	21%
	50s	23%	55%	22%
	60 and older	18%	49%	32%

Note: The support rate for each policy represents the relative scale of the utility level, which is calculated by inputting social security benefits, public services and public works projects, and potential national contribution rate figures shown in each policy proposal into estimated utility functions.

Section 2 From Public Sector to Private Sector – Various Methods

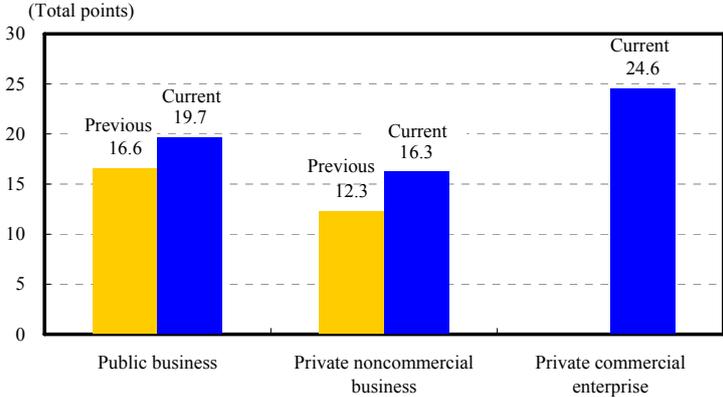
- As part of the policy “from public sector to private sector,” a Designated Management Entity System was introduced in 2003 through the amendment of the Local Autonomy Law to transfer the management and operation of regional public-related facilities to the private sector. The introduction of the scheme has resulted in improvements in service quality and efficiency.
- However, this system needs to operate with transparency, neutrality and fairness in terms of selection of businesses and project evaluation.

[Analysis]

- A Designated Management Entity System was introduced to comprehensively transfer the operation and management of public-related facilities of local governments to private commercial enterprises and non-profit organization (NPOs). After the introduction of the system, the Cabinet Office implemented a questionnaire survey of businesses (distributed to 1,461 businesses with a response rate of about 29.8%)
- The overall scores for indicators related to service quality (total of 48 items, with a maximum score of 48 points) shows that after introduction of the system, the current businesses offer an improved service over the previous businesses. By entity, the private commercial enterprises scored the highest. The same trend is evident in individual items such as response to users, and service times, etc. Private noncommercial businesses such as NPOs also scored highly on the “partnership with users” item.
- Through the introduction of the Designated Management Entity System although services improvements and enhanced efficiency effects have been witnessed, on the other hand, the businesses who have become the designated management entities have pointed out that a remaining challenge is to guarantee transparency in the process of selection of businesses.

Fig. 2-2-7 Service quality evaluation by entity

Looking at total points (average) each entity marked an improvement after introduction of the Designated Management Entity System

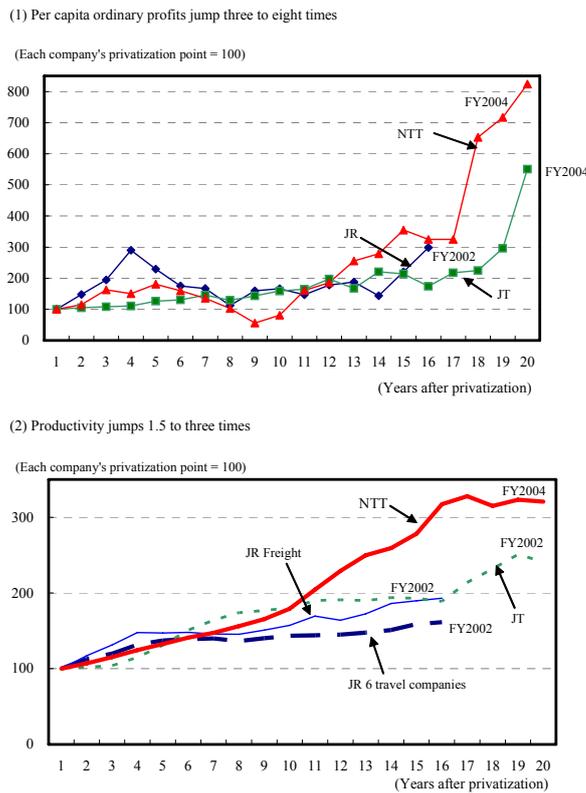


- Privatization contributes to improvements in efficiency, innovation and service diversity.
- The privatization of postal services will contribute not only to improved operating efficiency, but will also ensure that a system is created whereby funds in postal savings and postal life insurance are used effectively in the private sector.

[Analysis]

- The transfer of organizational structures from public to private through privatization lead to enhanced efficiency in disciplined mechanisms for managers, but also lead to the provision of diverse products through the promotion of innovation. In the cases of NTT, JR, and JT, each one of these companies increased their per capita ordinary profits from 3 to 8 times and saw productivity increase from 1.5 to 3 times.

Fig. 2-2-15 Changes in per capita profitability and productivity after privatization of NTT, JR and JT



- Notes:
1. *Privatization of the Japan Monopoly Sales Corporation* (Documents distributed at the Experts' Meeting on Postal Privatization), Japan Tobacco Inc. *Annual Report of Road Statistics*, Ministry of Land, Directory of Land Transport Statistics, and each company's securities reports.
 2. JT's productivity refers to labor productivity (No. of cigarettes produced / number of employees at each plant).
 3. JR's per capita profitability is the entire company's ordinary profit for all businesses / personnel numbers. In addition, JR's productivity is calculated by both the physical labor productivity of all JR companies (passengers x km traveled / personnel numbers) and physical labor productivity of JR Freight (freight ton-km carried / personnel).
 4. The per capita profitability at NTT is on a consolidated basis. Given the introduction of US accounting standards from FY2002, from FY2002 current net income is before tax. NTT's productivity is labor productivity (sales / personnel numbers).

Section 3 Reform of Local Public Finances

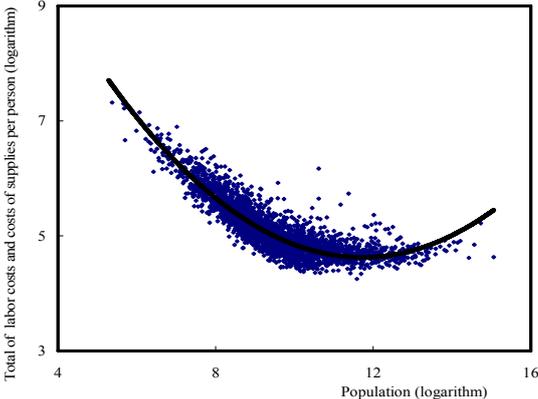
- Aiming to achieve small government, in addition to expanding the autonomy of local governments and reforming the uniform administration at a national level, it is important to increase the administrative fiscal efficiency of local governments. The reform of the fiscal relationship between the central and local governments and mergers of local authorities are part of this policy direction.

[Analysis]

- According to estimates, as the size of the municipalities increases through the mergers of local authorities, this will be accompanied by a decrease in administrative costs per unit. On the other hand, once the size of the municipalities exceeds a certain threshold, administrative costs per unit tend to increase as such municipalities are likely to take on some of the roles of prefectural government. Using the estimated coefficients and calculating the reduction in costs in the municipalities that actually merged in FY2002 and FY2003, it is suggested that many of these local authorities will see their costs decrease. In cases in which theoretical cost expansion is expected, the efficiency of the region as a whole could be enhanced as the designation of government-designated cities, major urban areas, and specially designated cities could result in costs reduction at the prefectural level.

Fig. 2-3-9 Relationship between population scale and labor costs / cost of supplies

Costs decrease as the population increases, but start to go up again after exceeding a certain point



Notes: 1. *Survey of Settlement by Local Authority and Overview of Population Based on Basic Resident Registers*, Local Public Finance Bureau, Ministry of Internal Affairs and Communications.
 2. The curved line on the graph is the approximate quadratic curve.
 LSC: Total of labor costs and costs of supplies per person(1,000s yen)
 POP: Population
 The following estimated equation was obtained.

$$\ln(LSC) = 14.835 - 1.741 \ln(POP) + 0.074 (\ln(POP))^2$$
 (113.86) (-65.62) (55.50)
 The sample number was 3,155.
 Figures in parentheses are t-values. The adjusted R-squared is 0.811.

Section 4 Challenges in Aiming for Small Government

- For the publicly regulated market, including medical care, nursing care, education and child-care, the private commercial agents have also entered parts of this market, hoping to contribute to improvements in efficiency.
- In market tests that directly compare private and public sector efficiency through competitive bids, the most efficient businesses are granted the project. In addition to introducing model projects on a trial basis in FY2005, a system will be created, including a legal framework.
- In advancing administrative efficiency through a policy of “from public sector to private sector,” it is important for the public sector to improve regulatory environment and to provide the businesses with competitive pressure.

[Analysis]

- In the selection of model projects for market tests, there were some projects that were not addressed in the projects for FY2005 because of the concerns over the exercise of government authority, maintaining confidentiality, the protection of personal information and the necessity for administrative decisions. It is necessary to continue to consider these systematic challenges.

Table 2-4-3 Details of the selection of the model projects for "market testing"

Receipt of proposals from private businesses - 119 proposals from 75 entities (Oct 18 2004 to Nov 17 2004)

Details of Major Proposals	No. of proposals
Hello Work-related (Public employment security office)	18 bus., 27 props.
Social-insurance-related	23 bus., 27 props.
Prison administration facilities-related	1 business, 1 proposal
Statistical survey-related	2 bus., 2 props.
Audit-related	2 bus., 4 props.
Facility maintenance and management-related	8 bus., 12 props.
Related to work and operations of independent administrative agency	3 bus., 3 props.
Support-related work for central government ministries and agencies, etc.	11 bus., 13 props.

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Consultation with relevant ministries and Cabinet Office (Nov-Dec 2004)

Results of responses from ministries	No. of responses
a. Candidates for "market testing" (model project)	18
b. Consideration on candidates for market test	13
c. Considered impossible or inappropriate for target for market test	76 (18 of which duplicated)
d. Already open to private sector	46 (18 of which duplicated)
e. Factual errors	21 (4 of which duplicated)

Note: There were four responses that could not be classified above. There were cases in which there were multiple responses to one proposal.



Model projects introduced in FY2005 on a trial basis - 3 areas, 8 projects (decided in 2004)

(1) Hello Work-related (Public employment security office)	Publicly funded, privately run career exchange plaza	5 / 15 nationally
	Publicly funded, privately run youth career exchange plaza	1 / 1 nationally
	Opening to private sector of recruitment search	3 regional / 77 nationally
	Opening to private sector of job training through the Ability Garden	1 / 1 nationally
(2) Social Insurance Agency-related	Promotion of application of employees pension and public servants health insurance for establishments which do not apply to insurance	5 (2 regions) / 312 nationally
	Collection project of national insurance premiums	5 / 312 nationally
	Operation of pension helpline	2 / 23 nationally
(3) Prison administration facilities-related	Assistance work for patrolling prison facilities and dealing with inmates	2 / 59 nationally

Reasons given by ministries concerning impossibility or inappropriateness of market test

Main reason	No.	Examples
(1) Associated with the use of public authority	23	<ul style="list-style-type: none"> • Support for collection of national taxes • Guidance on Hello Work operations for business proprietors • Statistics (providing field investigation rights to statisticians)
(2) Protection of individual/corporate information or state secrets	13	<ul style="list-style-type: none"> • Management, operation and custody of National Archives • Management of defense-related facilities • Information product projects at National Printing Bureau
(3) Necessity for fairness or neutrality	11	<ul style="list-style-type: none"> • Debt collection projects • Agency operation to receive fines or charges • Operation and management of youth development-related facilities
(4) Need for administrative judgment	9	<ul style="list-style-type: none"> • Approval of unemployment provision and decision on application for employment insurance affairs • Project to protect lifestyles
(5) Others	12	—

- Notes: 1. "Impossible" responses are stated as "consideration will continue to be given to projects for market testing towards the full-fledged introduction of the system" in the Three-Year Program for Promoting Regulatory Reform and Privatization (revision).
2. Of the responses that were considered "impossible or inappropriate" there were 58 classifications, excluding duplication. Because some proposals included multiple reasons in their response, the total number of cases listed above does not total 58.