Energy Deregulation Has Meaning

By Mitsuyu Hisao

A gasoline stand by the expressway interchange in Komaki, Aichi Prefecture—located in the middle of Japan's industrial zone—is now attracting the attention of drivers across the country.

Last May this gas station opened for business offering regular gasoline at ¥100 per liter, about 15% less than the normal local price and 20% less than the national average. Reminiscent of scenes from the oil crises in the 1970s, lines of cars waiting for a fill-up resulted; the amount of gas that the average Aichi filling station would take a month to sell, was sold out in two days.

This station is operated by the Kanare Beikoku rice store. Unlike most of Japan's filling stations it does not belong to any particular oil company grouping and, to top it off, it did not complete the registration procedures required under the Gasoline Retail Business Law. The Regional Bureau of International Trade and Industry stepped in and the station was subjected to administrative guidance, forced to choose an oil company to be its supplier, and to register.

Even after registering, the owner appears determined to continue selling ¥100 gas, but for how long he can do so remains a question as he must buy the gas at high keiretsu wholesale prices from the oil company.

There are two things of significance in the Kanare Beikoku case: consumers truly want cheap gasoline, and existing oil companies that have been protected by legal and administrative regulations are standing in the way. It is also a sign that challengers are appearing in the long-ailing gasoline market.

Japan is attempting to escape from a recession which has lasted since the beginning of this decade. However, during this period people have steadily become aware that even when the economy recovers it will be difficult to maintain the comparatively high growth rate of the pre-'80s that was sustained by large-scale manufacturing.

In past recessions the development of new products based upon technical innovations, improved productivity, strengthened competitiveness in exports, and industrial restructuring offered escape routes. However, there are only slight guarantees now that groundbreaking new technologies or industries will appear in our economy.

The confused post-Cold War world economy has no leeway to receive enormous amounts of Japan's industrial products. More to the point, the rapid increase in products manufactured with low wage costs from Asian and other newly developing countries, along with the recovery of price competitiveness of American products, have resulted in placing a large question mark on the international competitiveness of Japanese products, previously considered invincible.

There are many factors which have cast this shadow over the Japanese economy, but one of the greatest is the high cost of living compared to other developed nations. The high prices here have long been singled out, however, the ill effects were concealed by rising incomes which were underpinned by high growth.

In the midst of the first time since the Second World War that incomes have actually declined and corporate profits have continued to drop, extraordinarily high commodity price levels (referred to as internal/external market price differentials) have become an intolerable problem for the entire economy, corporations and household budgets alike.

At this point the array of administrative regulations has come to be singled out as the primary force behind the high cost of living that overwhelms Japan. Foremost among these, as symbolized by the Kanare Beikoku example, the high cost of energy is seen to be a typical regulatory outcome. As such, a great cry for regulatory relaxation is being raised to further efforts to lower energy costs, essential to the existence of both households and companies.

One could go so far as to say that there are few Japanese industries that have as many regulations as the oil, electric power, gas, and other sectors of the energy industry. This can be easily understood when considering the Petroleum Industry Law, Electricity Utilities Industry Law, Gas Utility Industry Law, and other comprehensive laws that have been enacted, and that a giant administrative agency, the Agency of Natural Resources and Energy, exists only to deal with these industry sectors.

There are no such basic laws for iron and steel, petrochemicals, and other former mainstays of industry nor for the automotive, electronics, and other industries that play leading roles in the Japanese economy. The administrative net over the agricultural and financial securities sectors, both of which have been singled out as most lacking in rationalization and improved efficiency, also falls over the energy industry.

It is inappropriate simply to criticize. In general terms, whether legislative or administrative guidance, government regulations (aside from those that resulted from undisguised political pressures) at least had some logical purpose and corresponding public support for the most part at the time they were implemented.

MITI in the lead

Today, Western nations often pour scorn on MITI-led industrial policies, with the accompanying array of regulatory measures as symbols of Japan's "abnormality" compared to advanced Western nations, and inappropriate government intervention in the market. However, I believe that these arguments ignore the historical conditions and the necessity, as well as inevitability, of policies in the developmental stages of a specific country's economy. Broadly speaking, not one democratic nation exists that does not put its own national interests first in the implementation of its policies.

Since 1945 Japan has depended on imports for three-quarters or more of its energy needs. In particular, it is a country that has had to procure 99% of its oil, its primary energy source, from overseas markets. The nation possesses an overly large population compared to its territory, is poor in domestic natural resources, and, moreover, is located in the Far East, geographically distant from resource producing nations.

Acquiring cheap, stable energy resources in order to enjoy high economic growth has truly been an overriding national interest. Even though it has subsequently been seen that the enactment of various laws and administrative acts related to energy, almost in parallel with the course of Japan's high-level economic growth, was in error, there were sufficiently legitimate objectives.

It appears that the end of the Cold War, which is thought to have fundamentally upset a range of economic preconditions, has probably also changed ideas regarding stable supplies, Japan's philosophy regarding energy policies for many years. Stable supplies are as important as ever, however, the issue of the cost paid to achieve this has come to the fore. It is imperative to realize that this will be a large factor in the issue of deregulation related to energy.

MITI, which administers the energy industry, was alert as ever in perceiving these changing times. In the summer of 1993 when the Liberal Democratic Party relinquished the seat of power for the first time in 38 years, the coalition Cabinet led by Prime Minister Hosokawa Morihiro came on the scene and suggested regulatory relaxation as one basic policy to overcome the serious recession and attempt to revive the Japanese economy. MITI took this opportunity to move toward proposals for new deregulation in energy policies.

With regard to oil, which is a particularly heavily regulated sector of the energy industry, deregulation in the form of loosening MITI supervision of facilities and production had already been underway since the 1980s. However, in conjunction with the abrupt changes in Japan's economic climate and conditions described above, the latest deregulation differs qualitatively from past efforts. In the sense that the new deregulation has the intent of boosting the efficiency of the energy industry and cutting costs by bringing energy prices in line with international levels, it has a whole new hue.

New thinking needed for new times

It may be that the content of regulatory relaxation related to the oil and electric power industries concluded in June 1994 was so modest that it could be difficult to perceive how much significance it might have for the average consumer. Regarding the decisions related to oil, only the abolishment of the Provisional Measures Law on the Importation of Specific Petroleum Refined Products—which stipulated that only imports of gasoline and other petroleum products through oil companies would be approved—by its end of March 1996 deadline, was remarkable.

Enacted in 1986 after Saudi Arabia and other Middle East oil producing nations showed signs of embarking upon petroleum refining and product exports of their own in the early '80s, this protectionist piece of legislation had the goal of protecting Japanese oil refineries if they were urged to import finished petroleum products. Because the law had a 10-year time limit and would naturally be abolished, the oil industry began furious efforts to have it extended. This was due to a petroleum product pricing scheme peculiar to this nation and perhaps difficult for other countries to comprehend.

In Japan, complex and differing taxes are levied on petroleum products by category and administrative guidance has additionally resulted in a situation in which gasoline is extremely expensive while similar product varieties, kerosene and light oil, are inexpensive. Kerosene is used for fuel in the average home and light oil is used to fuel diesel freight trucks, so there is public and political pressure to maintain low prices for both of these.

On the other hand, there is little resistance to high prices for gasoline, which is used by a large, but unspecified, number of people, resulting in a skewed pricing structure that sets gasoline prices especially high and guarantees oil companies the majority of their profits from gasoline. To the oil industry, which has used this law as a barrier to stem influxes of cheap gas from Singapore and other locations, the liberalization of gasoline imports through the abolition of the Provisional Measures Law on the Importation of Specific Petroleum Refined Products and the fear that they would lose their surplus profits from the domestic gasoline market were life or death issues.

Another issue that arose out of the latest deregulation was the reorganization of the various regulations based on the Gasoline Retail Business Law, the same act which was used to put a stop to Kanare Beikoku's discount sales. The Petroleum Council debated this and issues related to the Provisional Measures Law on the Importation of Specific Petroleum Refined Products, and various arguments regarding the necessity of government registration of gasoline stands were introduced, but in the end MITI's desires and the oil industry's insistence resulted in the retention of most of the existing regulations.

The new liberalization measures, including the abolition of the registration system, greatly affect operators of the approximately 60,000 gas stations across the country; the collapse of the gas prices that are the wellspring of oil companies' profits bears upon their corporate existence. Further, although this is mostly behind the scenes, Finance Ministry's intentions have also come into play because maintenance of gasoline prices and control over sellers is an absolute necessity in order to retain huge receipts from gas taxes (taxes make up half of the price of gasoline in Japan!).

Issues pertaining to the electric power industry are another focus of energy industry deregulation. Since Japan's electric power industry was divided up and organized into nine power companies with regional monopolies in

1951 (now 10 following the devolution of Okinawa to Japan), the system has remained basically unchanged.

However, an increasing percentage of energy demand has come to consist of electric power, and in conjunction with demand concentrated in Tokyo and other major metropolitan areas, the more than 40-year-old system will soon reach the limit of its abilities. Construction of atomic power plants or large thermal plants is difficult—from the aspects of safety and local opposition in the case of the former and due to environmental regulations in the latter case—so electric power companies are faced with the prospect of seeking power supplies from generators other than their own in order to meet their supply obligations.

This tied in with the approvals of new entries of non-electric power companies by establishing an electric power wholesale market, the main support of the latest regulatory relaxation related to electric power, and, although limited to certain regions, approval for companies other than the former electric power companies to supply electricity directly to consumers. Further, with the appearance of competitors supplying electric power it is to be expected that some competitive instincts, at least, and a desire to reduce costs will arise among the electric power companies who have been safely anchored by their regional monopolies.

However, whether oil or electric power, energy industries have survived for many years through administrative guidance and protection. While not discussed in this article, price regulations for the city gas industry and natural gas were only eased slightly and drastic structural reforms are still far off.

As can be seen, Japan's energy industry problems have clearly reached a point where mere deregulation will not be enough. In the petroleum industry, some 10 companies jostle with each other under a warped pricing system; electric power companies with regional monopolies are showing signs of arteriosclerosis; huge gaps between major and local gas companies exist.

The energy industry's inherent problems have yet to be resolved and it is faced with the necessity of becoming a resilient industry that possesses a structure that can endure deregulation. In short, reorganization is necessary.

In any event, the progress of the latest deregulation gives one the sense that we are moving away from the traditional Japanese policies that gave energy preferential treatment. From the standpoint that it has been demonstrated that it is not proper for Japan alone among the international economic community to make special exceptions, deregulation of the energy sector possesses symbolic and important significance for the economy as a whole. JJTI

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Revised Electric Power Supply Goal
(fiscal year end composition according to electric power sources)

(unit: 10,000kw)

FY / Source	1992 end	composition %	2000 end	composition %	2010 end	composition %
Atomic power	3,442	18.7	4,510	19	7,000	25
Coal	1,467	8.0	3,260	14	4,400	15
LNG	4,095	22.3	6,160	26	6,450	23
Hydropower	3,814	20.8	4,550	19	5,700	20
Propeller turbine	1,962	10.7	2,080	9	2,500	9
Pumped storage	1,852	10.1	2,470	10	3,200	11
Geothermal	24	0.1	60	0.2	280	1
Oil, etc.	5,542	30.1	5,340	22	4,500	16
New energy	—	—	50	0.2	180	0.6
Total	18,383	100	23,930	100	28,510	100

Electricity Utility Industry Council, June 1994