

Section 4 Seeking further development through realization of a seamless economic zone

As was seen so far, the harmonization of East Asia's intra-regional economy through EPAs/FTAs and the improvement of logistics infrastructures to support business activities have sparked moves by Japanese companies to optimize the overall business network, including efforts to establish a cross-border division of manufacturing process, intensify production items, and strengthen sales strategies capturing East Asia as a unit. This expansion and deepening of business networks in East Asia has spawned new innovations by Japanese companies and has contributed significantly to economic growth in East Asian countries through expanded trade and investment.

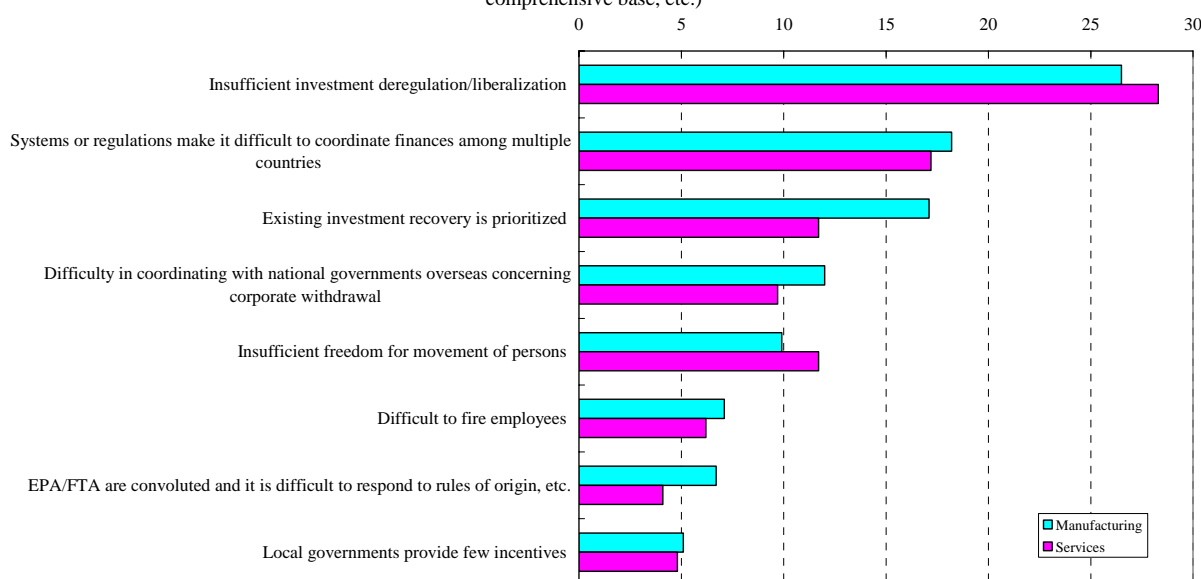
For the sustainable growth of East Asia, vigorous business activity by Japanese and other foreign-affiliated companies that lead to expansion of trade and investment is important. In this regard, it is needed further liberalization and harmonization of the business environments of countries in East Asia. This section will provide insights into how the systematic integration and institutions should proceed so as to create a seamless economic zone that will generate vitality not only in Japan but also in East Asia as a whole, while confirming the importance of improving the business environment by reviewing key issues to the business environments of East Asian countries which have been pointed out.

1. Issues on the business environment faced by Japanese companies

(1) Issues on the strategic placement of operating bases

As the EPAs / FTAs among countries in East Asia proceed economic integration and systemic harmonization of the area, and as the logistics infrastructures that supports business activities improve, the business environment of the area is getting favorable for Japanese companies. Japanese companies are setting up operating bases strategically through a cross-border division of manufacturing process, concentration of production functions, and strengthening of overall sales control functions aimed at intra-regional integration. However, all of these bases cannot be established freely in accordance with company strategies. Although companies are striving for efficiency in their business activities, they still come under various constraints imposed by the regulatory systems, infrastructure, and other elements of the business environment of the countries. For example, insufficient liberalizations and deregulations of investment in the countries of East Asia are most frequently mentioned by Japanese companies as the obstacles to their strategic placement of operating bases. Difficulties of performing financial management across multiple countries, and personnel and labor issues such as the movement of people and dismissal of employees are also mentioned (Figure 2-4-1).

Figure 2-4-1 Challenges when locating strategic bases in East Asia (advancing division of labor relations, establishment of comprehensive base, etc.) (%)



Notes: 1. Multiple responses concerning challenges in establishing strategic bases (advancing division of labor relations, establishment of comprehensive base, etc.) in the East Asian region by companies already operating in the region, and those companies that indicated the intention to establish a strategic base. No. of responding companies: Manufacturing: 434 companies, Services: 145 companies.

2. The values represent the proportion of all responding companies for each challenge.

Source: *SEICHOU WO TOGERU CHUUGOKU-INDO KEIZAI NO GENJIOBUNSEKI TO SAABISU SANGYOU WO FUKUMU WAGAKUNI KIGYOU NO KAIGAITENKAI NI KANSURU CHOUZA KENKYUU*, (JIPRI)(2007).

(2) Business risks in East Asian countries

Business environments in East Asia have been improved, but companies still hope further improvements. According to a questionnaire survey, Japanese companies consider the issues shown in the Table 2-4-2 as the business risks in each country. In terms of business risk, more than 50% of companies indicate that there are problems in China involving laws, taxation, and protection of intellectual property. In addition, a relatively higher percentage of companies point out that other types of business risk are associated with China than with other countries. Although China has implemented a variety of deregulation measures in fulfillment of its WTO membership obligations, the country has been criticized for the lack of transparency in applying its legal system and that further development of its business environment is required. As for other East Asian countries, more than 50% of companies point to problems such as political and social instability in the Philippines and Indonesia, and many mention the lack of infrastructure development in India and Vietnam (Table 2-4-2).

To expand the trade and investment that drives growth in East Asia, a business environment in which companies can more freely conduct their business activities must be developed. To achieve this, the issues currently viewed as obstacles are needed to be resolved.

Table 2-4-2 Business risks in each country

(Unit: %)

	China (n=596)	Thailand (n=353)	Indonesia (n=238)	Malaysia (n=245)	Philippines (n=177)	Singapore (n=244)	Vietnam (n=236)	India (n=201)
Political/social unrest	41.3	28.3	50.4	3.3	52.5	0.8	9.7	15.4
Incomplete legal system or problems with operation	59.9	5.9	28.2	6.5	13.0	0.0	32.2	35.3
Problems with protection of IPR	59.2	6.2	9.2	4.1	9.0	1.6	11.9	13.9
Risks and problems concerning taxes	33.2	7.6	15.5	6.5	7.3	2.0	10.2	17.9
High foreign exchange risk	20.5	9.1	23.5	5.3	7.9	3.3	8.5	6.5
Undeveloped infrastructure	21.6	7.4	29.8	7.8	32.2	0.0	47.9	57.2
High or rising personnel costs	28.4	20.4	5.5	13.9	4.0	39.3	5.1	3.5
Lack of concentration or development of related industries	4.7	6.2	15.1	12.7	20.9	3.7	31.4	18.4

Notes: 1. Population parameter (n) shows the number of companies with current business relations, or those seeking business relations.

2. Response rates are color coded - 40% and above are colored pink, between 20 and 40% are colored yellow, between 5 and 20% are white, and below 5% Source: *Questionnaire Survey on Foreign Business Activities by Japanese Companies FY2006*, (2007)(JETRO).

2. Individual issues

As shown above, various business risks and a number of obstacles for the establishment of operating bases in East Asian countries. The following discussion examines the specific issues associated with East Asian countries in areas such as infrastructure, intellectual property, finance, personnel, and labor.

(1) Issues associated with infrastructure

India involves the greatest risk in terms of infrastructure. Infrastructure development cannot keep pace with the rapid economic growth that has occurred in recent years, and companies point that there is a conspicuous lack of development of infrastructure in general, including electric power and roads (Figure 2-4-3).⁴⁷

Vietnam poses the second highest risk next to India. Most frequently mentioned is risk relating to distribution, such as the risk of closure of main roads due to typhoons. There are also concerns that the shallowness of Haiphong Port, which is located near industrial centers, restricts transport ships and limits cargo handling capacity. However, the most serious risk in Vietnam is that relating to electric power. In May and June, 2005, planned power shutdowns were implemented in 26 provinces of Vietnam's northern region, with others in 15 provinces in June 2006. The causes of these power shortages include the rise in electricity demand generated by the improved living standards of the Vietnamese people and the increase in foreign companies operating in the country. In addition, since hydroelectric power accounts for about 40% of Vietnam's electricity, the water supply system is affected by rainfall and dry periods and is thus unstable. It is also poorly prepared for droughts. In the northern region of Vietnam, there is currently a shortage of fundamental generating capacity and there are concerns about power shortages occurring over the next several years. Despite improvement measures, such as strengthening the capacity of thermoelectric power stations and expanding transmission line networks, no basic solution exists yet to meet rapidly growing electric power demand.

⁴⁷ Refer to Chapter 1, Section 4 for details.

In the Philippines, January 2006, the Japanese Chamber of Commerce & Industry of the Philippines performed its own comparative analysis of the investment environment in the Philippines and Thailand, and submitted the report⁴⁸ to President Arroyo. The report said that infrastructure developments were needed more in the Philippines.. Specifically, the Philippines' expenditure for infrastructure as a percentage of GDP is smaller than that of Thailand, expressways extend over shorter distances, and railway transport capacity is smaller. The report recommended that specific measures to solve these problems should focus on infrastructure development to link Subic, Manila and Batangas. The report also requested the government to promptly address such issues as construction of industrial waste treatment facilities, power shortages and high electricity charges, and municipal waste, air pollution, and traffic congestion in the Manila metropolitan area. Japan is moving to encourage action on issues such as the construction of an expressway linking the metropolitan area with Subic and the development of Subic Port facilities, and although some progress has been achieved, more improvements are needed.

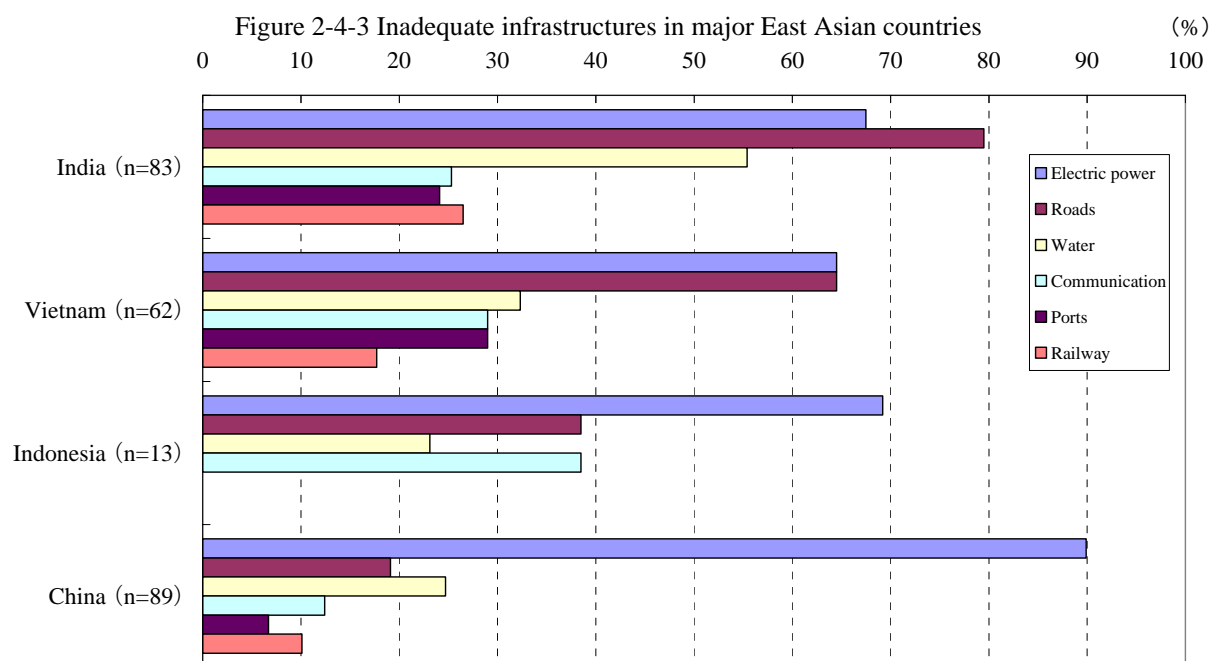
In Indonesia, it is said that existing infrastructures and their operation and maintenance systems have been deteriorated since the Asian currency and financial crisis. In the area of As for distribution, parts and products either do not arrive on schedule or cannot be shipped at all, because roads are chronically congested due to the inadequate road development. Port facilities development is also inadequate: the special automobile wharf at Tanjung Priok Port has a shortage of capacity, which could impede companies' import/export plans. Another area of concern is Indonesia's inadequate information infrastructure. The telephone line network is plagued by frequent noise, disconnections, and interference, and the Internet is often difficult to access. Furthermore, companies point to the instability and inadequacy of electric power supply, and equipment failures caused by sudden power outages and other problems have affected the production operations of foreign companies operating there.

China is pursuing aggressive infrastructure development in order to attract foreign-affiliated companies, and the three major coastal economic zones have been slated for improvement. However, there is a major disparity in infrastructure between urban and provincial areas, and electric power shortages and other problems with energy supply are prevalent. In 2005, power shortages occurred in 28 provinces and cities nationwide and in eight provinces and cities in 2006. Although efforts to relieve the tightness of electric power supply in China as a whole are underway through expansion of electric power facilities, in 2006, the electric power supply grew tight in the eastern region, the northern region and Liaoning Province. There was also a planned power shutoff in Guangdong Province and an unplanned power outage in Hubei Province in July, 2006. China has been working to prevent the reoccurrence of power shortages in 2007, bringing the Atsuka electric power facility on line in July 2007 and having begun construction of a nuclear power plant in the suburbs of Dalian City (Renboten City). In Guangdong Province, however, the power shortages are not attributed to a lack of generating capacity but to problems involving the transmission networks, and many

⁴⁸ The Japanese Chamber of Commerce and Industry of the Philippines, Inc. (2006), *Comparative Study on the Climate of Investment Between the Philippines and Thailand*

companies have expressed concern as to whether the increase in electric power demand over such a wide area can be met.

Transportation has also been mentioned as a problem area. Railway transport is the principal means of transportation in China, and although road transport and water transport supplements railways, the expansion of transport capacity is not altogether keeping pace with economic development. Moreover, companies complain that rail transport is delayed when there are military-related shipments of materiel. For these and other reasons, further efforts aimed at improving infrastructure are required.



Notes: For the survey done by the JBIC Institute, regardless of with or without a base, companies checked multiple answers for inadequate infrastructure in the country where they plan / consider promising to expand their business within the next 3 years.

Source: Satake, Takahashi (2007) "WAGAKNI SEIZOU KIGYOU NO KAIGAI JIGYOU TENKAI NI KANSURU CHOUHA HOUKOKU-2006 NENDO KAIGAI CHOKUSETSU TOUSHI ANKETO CHOUHA KEKKA (DAI 18 KAI)".

(2) Issues involved in the protection of intellectual property

An overwhelming majority of companies expressed concern about business risk in China relating to intellectual property. Many pointed out that counterfeit goods and pirated copies are prevalent in China and that there are problems involving legal systems and the application of law in this area. The protection of intellectual property and enforcement of related laws are also mentioned as issues in South Korea, Taiwan, the ASEAN countries and India.⁴⁹

These widespread fraudulent business practices such as counterfeit goods and pirated copies cause

⁴⁹ For example, at the overseas offices of JETRO in East Asia, the number of consultations concerning protection of intellectual property requested by Japanese-affiliated companies reached 3,129 in 2006, and JETRO is expanding its consulting services by assigning more counselors to China, South Korea, and Thailand, where a particularly large number of consultations are provided.

damages on the companies' business: loss of markets, loss of potential profits, and a decline in their brand image. Consequently, if a country cannot guarantee the protection of intellectual property, companies may lose the incentive to expand their operations to that country. For developing countries striving for growth through technical transfers by foreign-affiliated manufacturing companies entering their markets and seeking to promote research and development in their own country through the establishment of research facilities by foreign-affiliated companies, efforts to protect intellectual property are crucial (Table 2-4-4).

Table 2-4-4 Intellectual property problems and obstacles in Major East Asian countries and regions

	Intellectual property protection institution (Obstacles and requests)
China	<ul style="list-style-type: none"> •Commercial frauds such as counterfeit items and bootlegs are widespread, and improvement of condition, legislation, and operation is necessary. Example: Stronger regulations, strengthening provisions for preventing repeat offenses, increasing penalty for those violating rights. Applying global standards to Chinese laws.
South Korea	<ul style="list-style-type: none"> •Protection of trademark rights are inefficient, and evaluation systems for established trademarks must be improved. •From the FY 2006 Survey Report on Losses Caused by Counterfeiting by the Japan Patent Office, nearly 30% of Japanese companies have experienced losses caused by counterfeiting in South Korea. Thus, the regulation of counterfeit products need to be intensified.
Taiwan	<ul style="list-style-type: none"> •From the FY 2006 Survey Report on Losses Caused by Counterfeiting by the Japan Patent Office, more than 30% of Japanese companies have experienced losses caused by counterfeiting in Taiwan. After 2001, criminal penalties for patent rights, model utility rights, violating registered design copyrights, were removed, but they should be reissued, and counterfeit product regulations need to be intensified.
Hong Kong	<ul style="list-style-type: none"> •Established trademarks are using business names from third parties without their consent. Problems concerning established trademarks and registering trademark infringement have arisen. •Chinese counterfeits and bootlegs are exported through Hong Kong. Thus, regulations for commercial frauds such as counterfeit products and bootlegs are inefficient.
ASEAN	<ul style="list-style-type: none"> •Enforcement of executing rights protecting intellectual property rights are inefficient. •Commercial frauds are being distributed.
India	<ul style="list-style-type: none"> •There is an overflow of unauthorized copies, counterfeits, and bootlegs of software and games imported from Japanese companies. Thus, regulations for commercial frauds such as counterfeit products and bootlegs are inefficient.

Source: *The 2006 Report on the WTO Inconsistency of Trade Policies by Major Trading Partners* (METI 2006), *FY 2006 Survey Report on Losses Caused by Counterfeiting* (Japan Patent Office 2007), "2005 NEN KAKKOKU/CHIIKI NO BOUEKI/TOUSHI JOU NO MONDAITEN TO YUBOU" (Japan Business Council for Trade and Investment Facilitation (2006)), Other international intellectual property protection forum research.

(3) Issues in the financial area

The financial environment has been identified as an issue that pertains to East Asia as a whole in terms of its importance to the establishment of strategic bases and to the efficient movement and management of funds by companies. East Asian countries must take steps aimed at further improving the financial environment.

In view of the sudden outflow of capital and turmoil in financial exchange markets caused by the Asian currency and financial crisis, the East Asian countries are working to stabilize their exchange markets and establish independent financial policies while restricting the movement of funds in and

out of the region. Issues include the lack of liquidity in stock and credit markets, the undeveloped insurance market, the absence of a legal system dealing with securitization matters such as bankruptcy remote⁵⁰ and perfection⁵¹, and the difficulty of ascertaining the credit capability of business partners due to a lack of uniform credit information, which limits the provision of credit between companies.

In China, foreign currency deposit accounts are divided into different types depending on their use. These include foreign currency capital accounts used for the deposit of start-up funds from a parent company and current foreign currency accounts used to deposit and withdraw foreign currency funds for current transactions such as import/export transactions. The opening of all accounts requires the prior approval of the State Administration of Foreign Exchange. Restrictions on opening accounts have also been pointed out. Each company can open only one basic renminbi account for payments such as transfers between accounts, remittances, and issuance of checks, and for cash deposits and withdrawals. In addition, borrowing from a parent company involves the completion of complicated foreign loan registration procedures, and when loans are directed toward renminbi denominated payments where the amount per foreign exchange transaction exceeds US\$200,000, a renminbi payment instruction form must be submitted to the bank and payment must be made to the final recipient within two business days. When the amount of one foreign exchange transaction is US\$200,000 or less, the details of use of funds previously converted to renminbi must be submitted. Furthermore, when funds in local currency are moved within a corporate group, the “entrustment lending” method must be used whereby, in principle, funds are moved with the intermediation of a financial institution because only financial institutions that have obtained approval are allowed to conduct lending, which raises costs since a commission must be paid to the financial institution.

In Indonesia, Thailand, Malaysia and Vietnam, borrowing is difficult except in the case of short-term funds of less than one year. In addition, the amount that financial institutions can lent to the same corporate group is set depending on their capital amount. This condition may constrain borrowings of the Japanes companies on local currency basis when they merge or set up operations in the same area as an affiliated company. In Vietnam, prior approval and a separate borrowing registration certificate from the central bank of Vietnam is required when borrowing from the parent company involves a medium- to long-term loan (more than one year), even if the amount to be borrowed is within the range set at the time of license acquisition. Though these procedures usually can be completed within a few weeks, they sometimes can take a few months depending on the transaction.

In India, transfer of royalties for licensing of technology is limited to 8% of export value and 5% of domestic sales, and initial lump-sum payments accompanying contracts are limited to US\$2 million. If the amount exceeds this standard, the prior approval of the central bank is required.

⁵⁰ With securitization, a security is backed not by the credit capability of the holder of the original/underlying asset (originator) but by the value of the original asset itself such as real estate. Consequently, even if the originator goes into bankruptcy, attachment of the original asset must be prevented. Thus, the credit capability of the originator and the value of the original asset are independent, and there is no effect on the payment of principal and interest if the originator goes into bankruptcy.

⁵¹ In a securitization transaction this refers to the secured and protected transfer of the original asset from the originator to the transferee.

(4) Issues associated with personnel and labor

The most serious issue raised by Japanese companies concerning employment and labor in East Asia is the matter of increasing the wages of employees (Table 2-4-5).

Table 2-4-5 Problems of employment and labor in advancing Japanese companies

(unit: %)

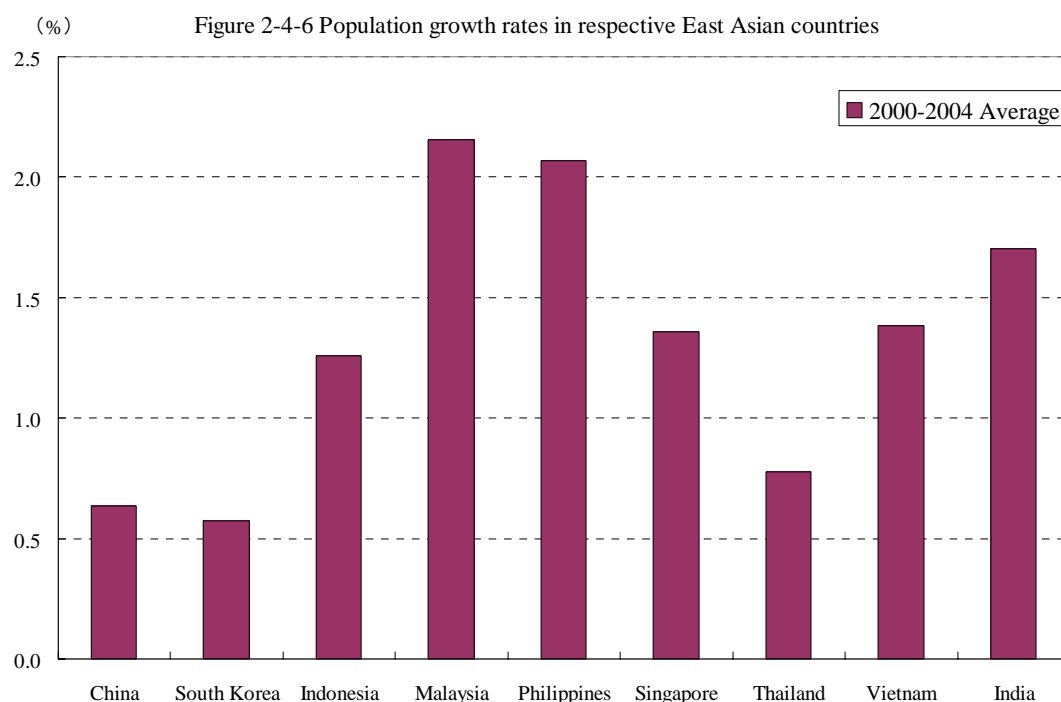
	First place	Second place	Third place	Fourth place	Fifth place
Thailand	Increase in worker wages	Difficulty of human resource (engineer) acceptance	Difficulty of human resource (middle management) acceptance	Localization of management, and site directors	Worker retention rate
	61.8	53.3	43.2	43.2	41.2
Malaysia	Increase in worker wages	Difficulty of human resource (engineer) acceptance	Difficulty of human resource (middle management) acceptance	Worker retention rate	Regulations for dismissal, downsizing
	50.3	37.9	36.1	33.1	30.8
Singapore	Increase in worker wages	Localization of management, and site directors	Difficulty of human resource (middle management) acceptance	Difficulty of human resource (engineer) acceptance	Cost of Japanese loaned workers (resident officers)
	61.7	33.0	29.8	27.7	26.6
Indonesia	Increase in worker wages	Regulations for dismissal, downsizing	Cost of Japanese loaned workers (resident officers)	Difficulty of human resource (middle management) acceptance	Labor problems (strikes, labor union problems)
	85.8	46.5	43.2	37.4	31.6
Philippines	Increase in worker wages	Localization of management, and site directors	Regulations for dismissal, downsizing	Difficulty of human resource (middle management) acceptance	Difficulty of human resource (engineer) acceptance
	60.2	43.6	40.9	38.1	37.6
Vietnam	Increase in worker wages	Difficulty of human resource (middle management) acceptance	Difficulty of human resource (engineer) acceptance	Cost of Japanese loaned workers (resident officers)	Localization of management, and site directors
	75.9	59.0	50.6	39.8	36.1
India	Increase in worker wages	Worker retention rate	Regulations for dismissal, downsizing	Labor problems (strikes, labor union problems)	Difficulty of human resource (middle management) acceptance
	72.1	36.1	32.8	31.1	26.2

Notes: 1. Multiple responses were made on problems seen on management, employment, labor areas by Japanese companies operating in the above countries

2. The categories above are the ones with the five highest responding rates..

Source: "ZAI AJIA NIKKEI SEIZOUGYOU NO KEIEI JITAI (SURVEY RESULTS) MARCH 2006"(JETRO (2006)).

One factor involved in wage increases is the tightness of the labor supply. In fact, a shortage of plant workers in industrial centers in China's southern district as well as in Thailand and Vietnam is emerging. In southern region of China, labor has been supplied by low-wage laborers from inland districts, but now it is said that labor supply from inland is declining. In Thailand and China, the rate of population growth is less than 1%, and there is concern that the labor supply of these countries will decline due to low birth rates and aging population in the mid- to long-term (Figure 2-4-6). Japanese companies also point out that hiring personnel with the desired ability is getting difficult as the competition for competent engineers and managers is intensified among companies.



Source: *Key Indicators 2005* (ADB).

Labor laws⁵² in East Asia, in general, are protective of workers and often are strict concerning the dismissal of employees. Problems frequently mentioned concerning Indonesia's labor laws include high retirement allowances, the fact that loss guarantees must still be paid even when dismissal is due to theft or violent behavior of the worker, and the necessity of obtaining government approval to dismiss employees (Table 2-4-7).

Table 2-4-7 Comparing systems of employment and dismissal

	Regulations for employment contract	Regulations for dismissal (excluding dismissal for reorganization)
Thailand	Contracts with a set term have difficult principles	During the probation period (up to 119 days) dismissal can happen at any time.
Malaysia	Contracts with a set term have difficult principles	Proper dismissal processes must be taken, and papers showing the reason must be prepared.
Indonesia	Except for temporary and seasonal work, there are no contracts with set term.	According to current labor law, the employer must receive the approval of the Labor Ministry, to dismiss an employee. If dismissal is done without proper processes, such as repeated warnings, according to the labor law, the dismissal is considered to be a dismissal on behalf of company interests.
Philippines	Employees who have been employed for more than 6 months must be made a permanent employee.	In order for a dismissal, there must be a notice to the employee, and after gathering documentary evidence, the papers must be submitted to a lawyer twice. (twin notice).
Vietnam	Even if it is a contract for a set term, after the third renewal, the contract must be permanent.	One can unilaterally terminate a contract only in special conditions such as constant delinquency of an employee, and for disciplinary measures.
China	Contracts are normally 1-3 years. But if employment exceeds 10 years, the contract must be made permanent. Probation periods can be set to be up to 6 months.	Dismissal is possible by not renewing a contract. But in the labor contract law currently progressing, there is a condition being added; to pay a compensation fee for ending an employment after their employment term has expired.
India	When employment period exceeds 180 days, the employed person has the right to become a permanent employee.	Besides for a wrongful act, in a company with more than 100 workers, when dismissing a worker, the approval of the state government is needed in advance.

Quoted by: Wakamatsu (2007) "ASIA SHOKOKU NO Roudouryoku Kankyou to Nikkei Kigyou no Taiou."

⁵² Refer to Chapter 1, Sector 4 concerning the problem of India's labor laws.

3. Achieving a seamless economic zone

East Asia's intra-regional economy is undergoing integration, as seen, for example, in the robust exchange of goods, money and people, along with the system harmonization through EPAs/FTAs. As the business environment of East Asia is getting harmonized, and the logistic functions is getting advanced due to infrastructure development in each country and diversified services provided by distributors, Japanese companies, seeking for further efficiency of the business, are expanding and deepening their business networks in the area. Business expansion in East Asia has brought about innovation that takes advantage of various characteristics of the area. By this, Japanese company has gained sustainable growth potential. At the same time, the expansion and deepening of business networks by companies will spur growth of the regional economy through expanded trade and investment and contribute to stimulating the East Asian economy.

Although the business environment in East Asia has improved in recent years thanks to the expansion of EPA/FTA networks, deregulation, and infrastructure development, as discussed in this section, various issues to be tackled still remain in East Asia. Differences in regulations in each country may impede free business activities, because companies must bear additional cost to deal separately with each country's systems. To generate a vigorous economic growth in East Asia, further development of rules in each country is needed. In addition, for this purpose, building a seamless economic zone based on a framework of economic partnerships that covers whole East Asia, in other words, comprehensive systemic harmonization including liberation of trade (both goods and service), upgrading investment rules, securing movement of people, and protection of intellectual property rights is also desired.