



The Economic Analysis of
International Production/Distribution Networks
in East Asia and Latin America:
The Implication of
Regional Trade Arrangements

Fukunari Kimura and Mitsuyo Ando
(Keio University)

1. FTAs and FDI

- Motivation for concluding FTAs by LDCs
 - Market access to DCs' market (classic)
 - Stimulating inward FDI (wave of globalization)
 - FDI: a bundle of capital, technology, managerial ability, access to foreign markets, and others
- Development strategies: EA vs. LA
 - EA: dual-track approach, formation of International production/distribution networks in the 1990s
 - LA (except Mexico): FDI is still import-subst.-type
- Implication for the design of FTAA?

2. The formation of international production/ distribution networks

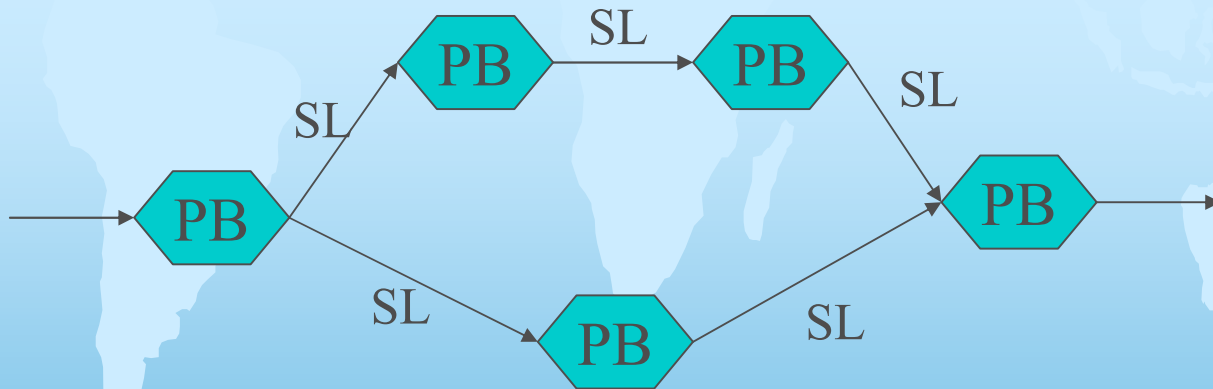
- Unprecedented formation of International prod./dist. networks in EA
 - Vertical chains of production + world-wide distribution network
 - Major players: firms in machinery industries
- Economic logic
 - Traditional trade theory of comparative advantage
 - Wages, technology transferability
 - New lines of thought
 - Fragmentation theory
 - Agglomeration theory
 - Internalization theory of “firm”

Figure 1 Fragmentation

Before fragmentation



After fragmentation



PB: production block
SL: service link

Figure 2 Agglomeration or industrial clusters

Economies of scale in the spatial version
“Agglomeration makes agglomeration”

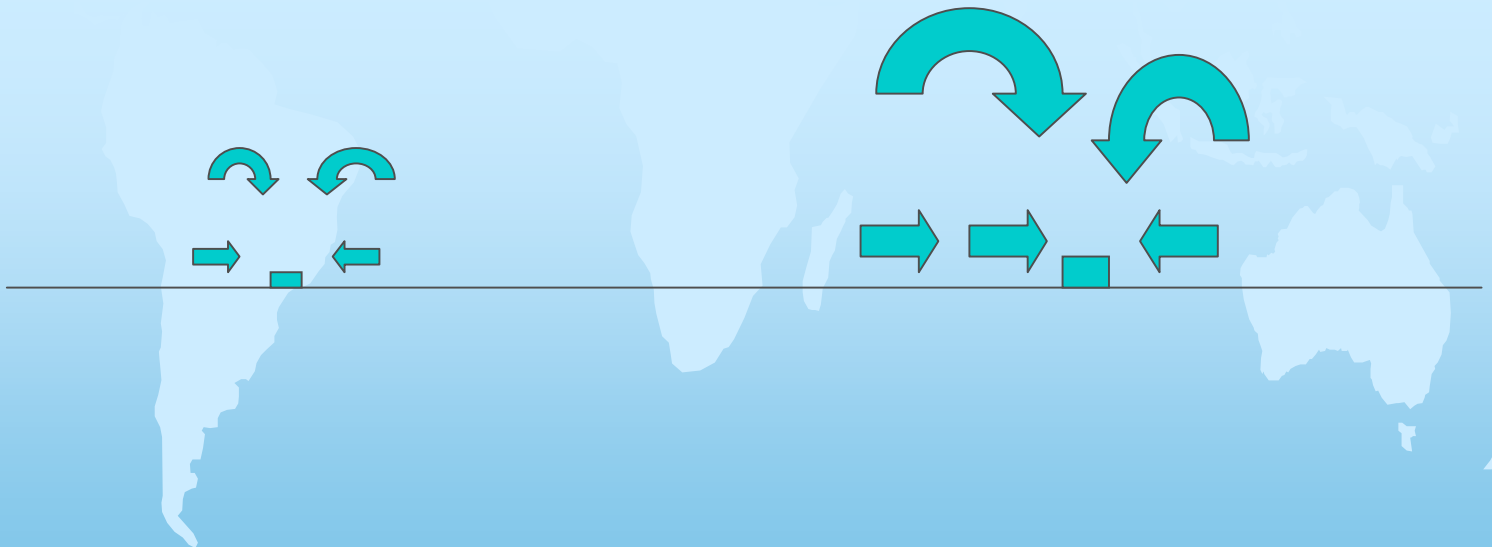
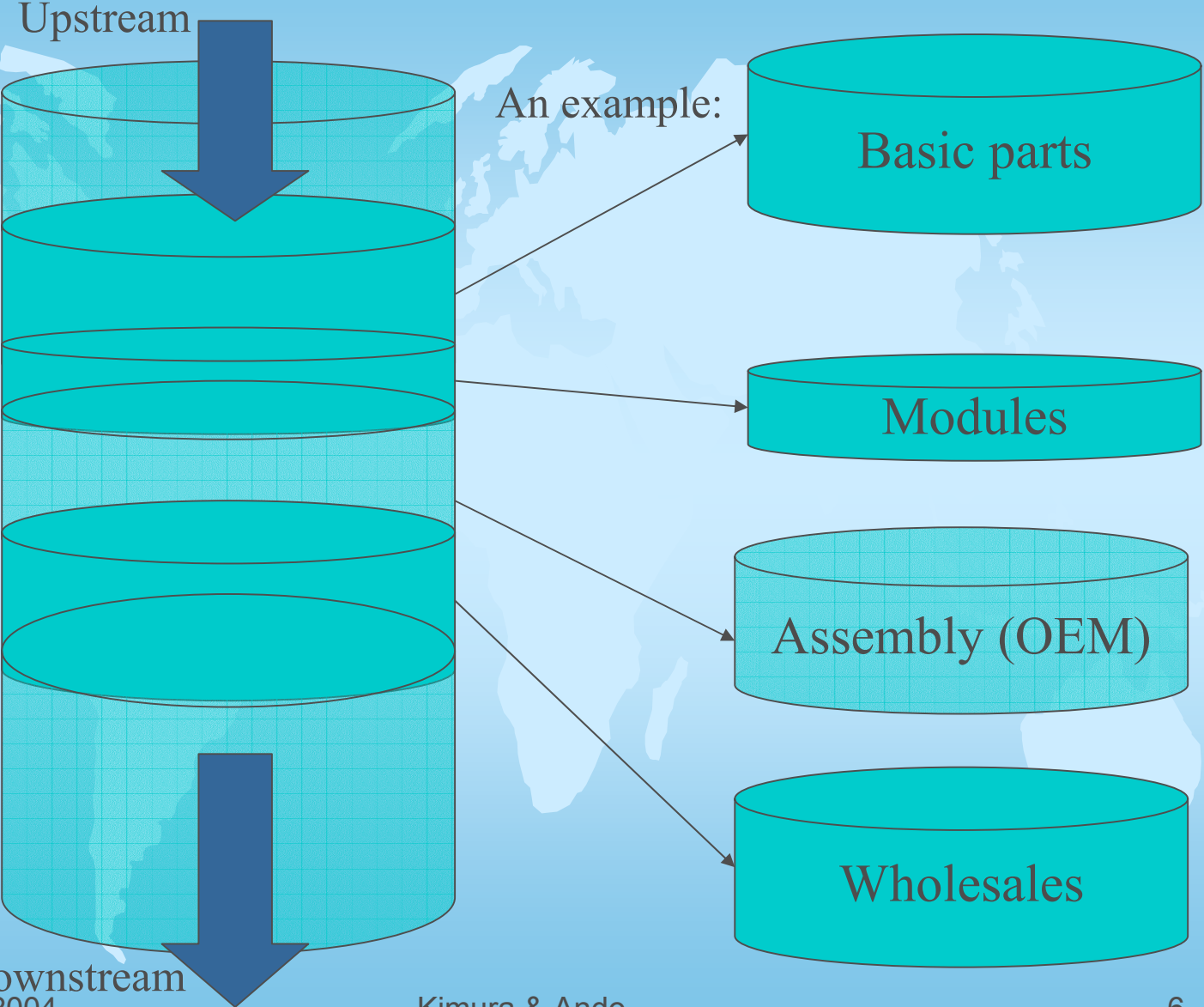


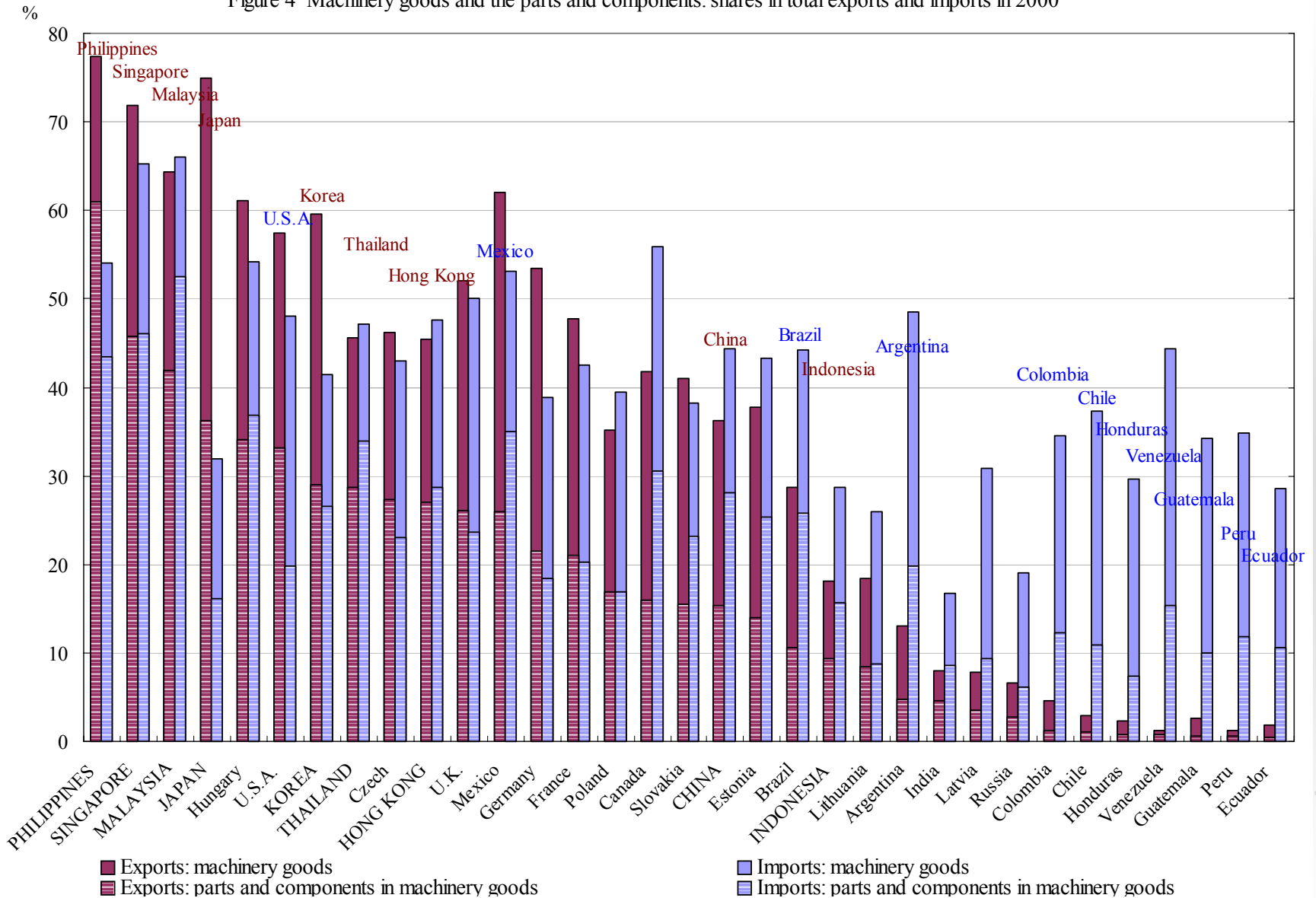
Figure 3 Internalization and location decisions



Networks in East Asia

- Distinctive features
 - Significance in each country's economy
 - Extensiveness covering a number of countries
 - Sophistication including intra-firm and arm's-length transactions (including those b/w different firm nationalities)
 - cf. US-Mexico, Germany-Czech/Hungary
- Background
 - “Accept everybody” policy to aggressively utilize FDI
 - Policy package to reduce service link costs and create a critical mass of agglomeration

Figure 4 Machinery goods and the parts and components: shares in total exports and imports in 2000



3. Differences in investment pattern:

EA vs. LA

- EA vs. LA: about the same economic size, however, far from EA investors
- Observation from micro data of Japanese firms
 - The number of affiliates, weights of manufacturing, machinery industries (Table 1)
 - FDI by SMEs (Table 2)
 - “Sector switching” pattern (Table 3)
 - Intra-regional sales and purchases (Table 4)
 - Firm nationality approach (Figure 5)
 - In EA, international prod./dist. networks are actively utilized. In LA, no evidence on the existence of such networks (except US-Mexico).

Table 1 Japanese Parent Firms and Their Foreign Affiliates by Industry (excerpt)

Industry	By industry of parent firm				By industry of affiliate		By industry of parent firm				By industry of affiliate	
	# of parent firms	%	# of affiliates	%	# of affiliates	%	# of parent firms	%	# of affiliates	%	# of affiliates	%
	(a) Parent firms with affiliates in East Asia						(b) Parent firms with affiliates in Latin America					
Manufacturing	2050	68	6296	62	6082	59	197	68	385	35	286	26
Non-machinery sectors	1038	35	2910	28	3198	31	90	31	157	14	136	12
Machinery sectors	1012	34	3386	33	2884	28	107	37	228	21	150	14
290	286	10	810	8	543	5	32	11	58	5	36	3
300	429	14	1598	16	1475	14	35	12	94	8	68	6
310	222	7	752	7	664	6	31	11	65	6	40	4
320	75	3	226	2	202	2	9	3	11	1	6	1
Non-manufacturing	944	32	3928	38	4142	41	91	32	725	65	824	74
480	697	23	3350	33	2627	26	73	25	700	63	308	28
Others	247	8	578	6	1515	15	18	6	25	2	516	46
Total	2994	100	10224	100	10224	100	288	100	1110	100	1110	100
% in total foreign affiliates		79		54		54		8		6		6

Table 2 Foreign affiliate ownership patterns of Japanese parent firms (number of parent firms)

# of regular workers of parent Firm	Number of affiliates												Total	%
	1	2	3	4	5	6	7	8	9	10	More			
in East Asia (2000 F/Y)														
50 to 99	301	67	25	12	1	2	1	.	.	.	1	410	13.7	
100 to 199	413	101	34	23	7	1	2	.	2	.	.	583	19.5	
200 to 299	196	92	30	12	8	10	3	2	1	.	1	355	11.9	
300 to 499	242	99	36	28	18	8	6	4	2	.	4	447	14.9	
500 to 999	209	117	65	42	27	20	5	2	4	2	10	503	16.8	
1,000 and more	136	107	77	54	55	45	27	38	16	19	122	696	23.2	
Total	1497	583	267	171	116	86	44	46	25	21	138	2994	100.0	
in Latin America (1995 F/Y)														
50 to 99	15	1	.	.	.	.	.	.	.	1	.	17	5.9
100 to 199	15	2	.	.	.	.	.	.	.	.	.	17	5.9
200 to 299	6	3	1	.	1	.	.	.	.	.	.	11	3.8
300 to 499	22	5	.	2	.	.	.	.	.	.	.	29	10.1
500 to 999	27	2	.	.	2	.	.	.	.	.	.	31	10.8
1,000 and more	89	37	22	5	7	7	2	1	1	2	10	183	63.5	
Total	174	50	23	7	10	7	2	1	1	3	10	288	100.0	

Table 3 Sector switching between parent firms and their affiliates

(a) Industries of Japanese parent firms and their affiliates in East Asia, 2000 F/Y (number of affiliates in East Asia)

Industry of parent firm	Industry of affiliate in East Asia																							480	Other	Total
	120	130	140	150	160	170	180	190	200	210	220	230	240	250	260	270	280	290	300	310	320	340				
120	145	1							2															20	15	183
130	5	28							12															19	10	74
140			70	7				2			2								1	2		2	10	0	96	
150			5	73					2		2								1				12	1	96	
160					14	1																	1	2	0	18
170					2	25																	1	8	0	36
180							45				2							1					5	3	56	
190								63														1	6	4	7	81
200	9	2	43	4	1		1	3	520	3	15	2		4		4	7	6	8	1	3	10	174	47	867	
210									2	2	4								1				9	18	36	
220									7		184	6		1		1	2	2	8	1		5	33	4	254	
230		1							1		3	89					2	1			4	1	3	15	8	128
240													6										1	0	7	
250			1						1		4			87		1	7	1	3	1	4	2	21	26	159	
260														1	51	3	10	2	8	4			7	29	115	
270									1		2	1		1		161	14	3	30	14		2	30	23	282	
280	1		1		2			1			4			2		14	161	7	27	5	1	8	34	9	277	
290	4								10		4			1	8	1	15	362	65	20	18	15	214	73	810	
300			2	2		1		1	5		12			5	1	3	6	79	1009	6	17	9	308	132	1598	
310						1					2			2	5		9	22	25	569		3	59	55	752	
320			1						2		1			3			1	6	14		131		56	11	226	
340			1					1			10	1					2		2		3	66	48	11	145	
480	115	11	83	157	13	8	14	9	142	11	60	22	3	70	47	32	63	39	266	34	22	56	1516	557	3350	
Others	5	0	1	15	6	1	1	0	4	1	2	0	2	2	1	2	4	12	7	3	1	9	23	476	578	
	284	43	208	258	38	37	63	80	709	17	313	121	11	179	113	222	303	543	1475	664	202	199	2627	1515	10224	

(b) Industries of Japanese parent firms and their affiliates in Latin America, 1995 F/Y (number of affiliates in Latin America)

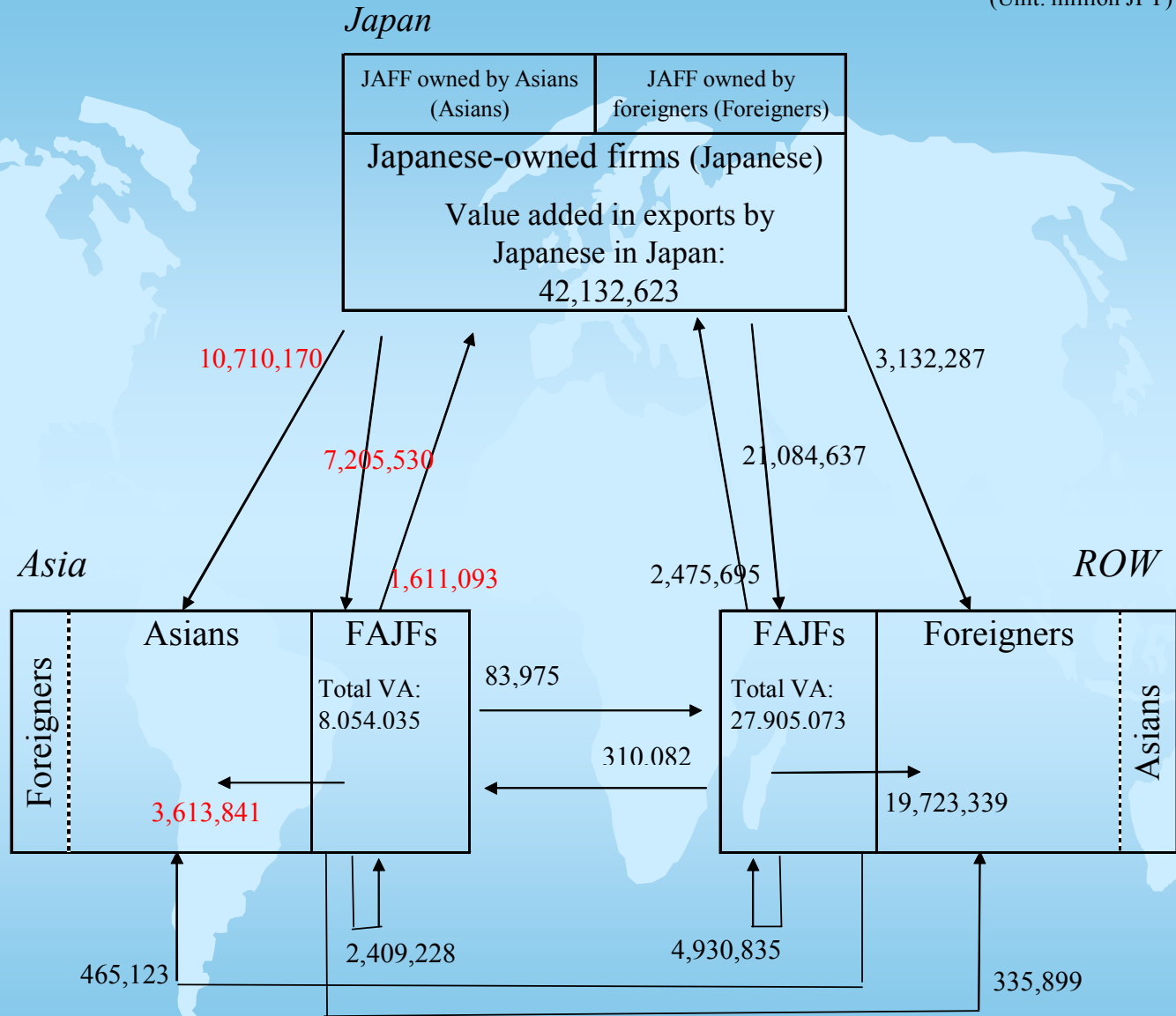
Industry of parent firm	Industry of affiliate in Latin America																				480	Other	Total				
	120	130	140	150	160	170	180	190	200	210	220	230	240	250	260	270	280	290	300	310				320	340		
120	5	1																						5	10	21	
130		2							1															1	9	13	
140			9																				1	1	11		
150			2	3																						5	
160					1																		1		2		
170						1																				1	
180																									3	3	
190								2																		2	
200	4		6						18		2													5	8	43	
210																								7	3	10	
220																									1	1	
230																										0	
240																										0	
250									1					1												1	3
260										1					5								1	1	5	13	
270																3									2	6	
280																	11							1	6	18	
290																		26	1	2				17	12	58	
300																		1	5	46			1	33	8	94	
310																1		1			33			11	19	65	
320																						3		5	3	11	
340																							2	3		5	
480	13	1	7		6	1	3		6			1			4	3	3	2	21	4	1			217	407	700	
Others					3						1		0	1	9	7	15	2				1			18	25	
	22	4	24	3	10	2	3	2	26	1	3	1	0	1	9	7	15	36	68	40	6	3	308	516	1110		

Table 4 Intra-regional production networks: sales and purchases by Japanese affiliates in East Asia, 1998 F/Y (excerpt)

Industry	Number of affiliates	%	Share in total sales (%)							Share in Total Purchases (%)						
			Local	Japan	Third countries (Total)				Local	Japan	Third countries (Total)					
					East Asia	North America	Europe	Latin America			East Asia	North America	Europe	Latin America		
(a) East Asia																
Manufacturing Sector																
120+130	162	2.6	69	16	15	6	3	4	0	79	7	15	8	0	0	2
140+150	399	6.4	44	30	26	12	5	7	0	54	27	19	13	2	1	0
160	23	0.4	15	56	28	24	1	0	0	94	3	3	0	0	3	0
170	14	0.2	53	34	13	9	4	0	0	75	14	11	8	0	3	0
180	36	0.6	74	12	13	9	4	0	1	62	21	17	14	2	1	0
190	27	0.4	78	0	22	12	0	5	0	74	17	10	0	2	8	0
200	529	8.5	70	7	24	16	5	2	0	54	19	27	13	7	2	0
210	17	0.3	21	66	13	3	0	10	0	22	18	60	45	10	4	0
220	109	1.8	65	20	15	10	2	3	0	68	26	6	5	0	1	0
230	54	0.9	41	34	24	13	5	5	0	57	24	19	17	0	2	0
240	16	0.3	5	21	74	22	44	8	0	10	7	83	41	10	3	6
250	160	2.6	70	17	13	9	4	1	0	41	32	27	23	3	0	0
260	166	2.7	85	3	12	7	3	0	2	19	70	11	10	0	0	0
270	110	1.8	56	16	29	26	1	1	0	44	32	24	19	0	1	0
280	121	1.9	71	13	16	12	2	1	0	68	29	3	2	0	1	0
290	315	5.1	32	41	27	15	5	5	0	58	32	10	9	1	0	0
300	916	14.7	32	33	35	25	5	3	1	36	37	27	26	0	0	0
310	478	7.7	81	11	8	2	3	1	0	53	37	9	6	2	1	0
320	100	1.6	27	46	27	23	2	2	0	40	41	19	14	3	1	0
330+340	83	1.3	22	64	14	3	7	3	0	55	38	7	6	0	1	0
Manufacturing total			49	25	25	17	5	3	0	43	35	22	19	2	1	0
Non-Manufacturing Sector																
050	11	0.2	33	67	0	0	0	0	0	98	2	0	0	0	0	0
480	957	15.4	41	19	39	33	2	3	0	28	35	36	28	2	3	1
540	170	2.7	88	6	6	5	0	0	0	75	21	4	1	2	0	0
Others	1240	20.0	70	15	15	10	3	2	0	71	18	11	9	0	1	0
Total	6213	100.0	50	22	28	21	3	3	0	41	33	25	21	1	1	0

Industry	Number of affiliates	%	Share in total sales (%)							Share in Total Purchases (%)						
			Local	Japan	Third countries (Total)				Local	Japan	Third countries (Total)					
					East Asia	North America	Europe	Latin America			East Asia	North America	Europe	Latin America		
(b) Latin America																
Manufacturing Sector																
120+130	11	1.4	79	9	12	0	2	7	1	100	0	0	0	0	0	0
140+150	30	3.7	86	6	8	0	5	0	2	68	3	30	1	14	0	9
160	6	0.7	28	23	49	3	31	3	4	100	0	0	0	0	0	0
180	2	0.2	10	38	53	4	13	31	4	0	0	0	0	0	0	0
200	23	2.8	88	0	12	0	3	0	8	72	6	22	0	21	1	1
210	2	0.2	96	4	0	0	0	0	0	87	2	12	0	12	0	0
220	2	0.2	100	0	0	0	0	0	0	95	5	0	0	0	0	0
250	6	0.7	24	2	75	0	75	0	0	16	14	71	12	58	0	0
260	9	1.1	97	3	0	0	0	0	0	38	43	20	2	18	0	0
270	4	0.5	24	29	48	2	17	29	0	86	0	14	0	14	0	0
280	4	0.5	100	0	0	0	0	0	0	52	27	21	0	21	0	0
290	24	3.0	75	2	23	1	17	3	1	58	28	14	0	8	5	0
300	69	8.5	79	5	16	0	13	1	2	46	33	21	14	2	4	0
310	62	7.7	83	0	16	0	13	0	3	39	49	12	1	9	2	0
320	6	0.7	83	1	16	0	4	3	9	45	39	16	16	0	0	0
330+340	8	1.0	50	45	5	0	5	0	0	16	27	57	0	57	0	0
Manufacturing total			71	8	21	1	12	6	2	54	29	17	5	8	2	0
Non-Manufacturing Sector																
050	22	2.7	8	37	55	20	5	16	13	86	0	14	0	14	0	0
480	160	19.8	69	7	24	0	2	1	21	24	51	25	4	15	0	5
540	15	1.9	100	0	0	0	0	0	0	56	31	13	0	13	0	0
Others	344	42.5	41	35	24	3	2	17	1	47	40	13	3	3	2	4
Total	809	100.0	63	12	26	3	7	5	11	39	40	21	4	12	1	3

Figure 5 Japanese value added embodied in sales to Asians and foreigners by Japanese: three-country setting (2000)
 (Unit: million JPY)



3. Differences in investment pattern: EA vs. LA (conti.)

- Evidence from the US-BEA data on US MNEs
 - Heavier weights on non-manufacturing (Table 5)
 - Weights of manufacturing, machinery industries (Table 6)
 - By-destination sales (Table 7)
 - Similar to Japanese firms in that they utilize international prod./dist. networks in EA, and do not in LA.

Table 5 U.S. parent firms and majority-owned non-bank foreign affiliates by industry, 1999 F/Y

Industry	By industry of parent firm				By industry of affiliate	
	Number of parent firms	%	Number of affiliates	%	Number of affiliates	%
Manufacturing sector	1300	54	13541	64	7601	36
Non-machinery sectors	746	31	7709	36	4744	22
Machinery sectors	554	23	5832	28	2857	14
Machinery	169	7	1428	7	885	4
Computer and electronic products	235	10	1781	8	878	4
Electrical equipment, appliances etc.	56	2	676	3	308	1
Trasnport equipments	94	4	1947	9	786	4
Non-manufacturing sector	1109	46	7598	36	13538	64
Wholesale trade	262	11	1613	8	4907	23
Others	847	35	5985	28	8631	41
Total	2409	100	21139	100	21139	100

Table 6 Sales and gross products by U.S. majority-owned non-bank affiliates in East Asia and Latin America by industry

	East Asia (2846)		Latin America				Share of Brazil and Mexico
			Total (3403)		excl. Brazil and Mexico (2078)		
	Value	%	Value	%	Value	%	
(a) Sales (million US\$)							
Manufacturing	112,036	47.9	130,977	53.3	35156	31.7	73.2
Non-machinery sectors	33,479	14.3	73,155	29.8	29152	26.3	60.2
Machinery sectors	78,557	33.6	57,822	23.5	6,004	5.4	89.6
Machinery	3,781	1.6	7,342	3.0	285	0.3	96.1
Computer and electronic products	68,613	29.4	14,382	5.9	1456	1.3	89.9
Electrical equipment, appliances, etc.	2,747	1.2	2,747	1.1	234	0.2	91.5
Transport equipments	3,416	1.5	33,351	13.6	4029	3.6	87.9
Non-manufacturing	121,656	52.1	114,592	46.7	75,839	68.3	33.8
Wholesale trade	75,337	32.2	40,422	16.5	28080	25.3	30.5
Others	46,319	19.8	74,170	30.2	47759	43.0	35.6
Total	233,692	100.0	245,569	100.0	110995	100.0	54.8
(b) Gross products (million US\$)							
Manufacturing	22,079	44.0	33,833	57.0	9120	34.9	73.0
Non-machinery manufacturing	8,938	17.8	23,164	39.0	8080	30.9	65.1
Machinery sectors	13,141	26.2	10,669	18.0	1,040	4.0	90.3
Machinery	1,042	2.1	2,220	3.7	71	0.3	96.8
Computer and electronic products	10,628	21.2	1,069	1.8	232	0.9	78.3
Electrical equipment, appliances, etc.	648	1.3	805	1.4	59	0.2	92.7
Transport equipments	823	1.6	6,575	11.1	678	2.6	89.7
Non-manufacturing	28,067	56.0	25,528	43.0	17,000	65.1	33.4
Wholesale trade	7,636	15.2	5,568	9.4	3869	14.8	30.5
Others	20,431	40.7	19,960	33.6	13131	50.3	34.2
Total	50,146	100.0	59,361	100.0	26120	100.0	56.0

Table 7 By-destination sales by U.S. majority-owned non-bank affiliates (excerpt)

	# of affiliates	Share in total sales (%)								
		Local		U.S.		Third countries (Total)				
			other U.S. affiliates		U.S. parent firms	other U.S. affiliates	East Asia	Europe	Latin America	
East Asia	2846	56.2	(8.1)	17.1	(87.0)	26.7	(59.4)	17.1	n.a.	0.9
Latin America	3403	65.8	(7.6)	17.5	(88.0)	16.8	(57.5)	2.3	5.4	7.8
Mexico	799	64.0	(12.5)	27.4	(91.1)	8.6	(72.5)	1.0	1.7	4.5
Brazil	526	83.9	(3.0)	5.8	(85.6)	10.2	(60.3)	0.3	3.6	5.9

4. The assessment of investment climate

- JBIC survey (Tables 8, 9)
 - China and other EA: great FDI attractor
 - Attractive factors: market, labor, agglomeration, fragmentation
 - Impediments: infrastructure, transparency, fairness, predictability
- Business costs and governance indicators (Table 10)
 - EA dominates LA in most of the indicators
- “Complaints” on LA by Japanese firms (BCFTI) (Table 11)
 - Re: RTAs, uncertainty and instability in policies

Table 8 Prospective destination countries for Japanese FDI (excerpt)

2001 F/Y				2002 F/Y			
Destination country		Number of firms		Destination country		Number of firms	
(a) Short run (incoming 3 years)							
		401	100%			418	100%
1	China	327	82%	1	China	373	89%
2	United States	127	32%	2	Thailand	118	28%
3	Thailand	99	25%	3	United States	108	26%
4	Indonesia	56	14%	4	Indonesia	63	15%
5	India	52	13%	5	Vietnam	62	15%
6	Vietnam	48	12%	6	India	54	13%
7	Taiwan	44	11%	7	Korea	34	8%
8	Korea	33	8%	7	Taiwan	34	8%
9	Malaysia	32	8%	9	Malaysia	33	8%
10	Singapore	24	6%	10	Brazil	19	5%
11	The Philippines	22	5%	11	Singapore	18	4%
12	Germany	19	5%	12	The Philippines	17	4%
13	Brazil	18	4%	13	Germany	16	4%
13	Mexico	18	4%	14	Mexico	15	4%
15	France	17	4%	15	Czech	13	3%
16	Czech	15	4%	16	United Kingdom	11	3%
17	United Kingdom	14	3%	16	Russia	11	3%
18	Hungary	12	3%	18	Poland	10	2%
19	Poland	11	3%	19	Hong Kong	9	2%
20	Hong Kong	8	2%	19	Hungary	9	2%

Table 9 Prospective destination countries for Japanese manufacturing FDI: their strong and weak points

Ranking	1	2	3	4	5	6	7	7	9	10
Country	China	Thailand	U.S.	Indonesia	Vietnam	India	Korea	Taiwan	Malaysia	Brazil
(a) Strong points										
Number of firms ¹⁾	373	112	108	61	54	50	32	32	30	19
Market potential	86.3	54.5	39.8	47.5	55.6	84.0	53.1	53.1	33.3	73.7
Inexpensive labor	68.9	48.2	0.9	73.8	70.4	60.0	12.5	15.6	40.0	26.3
To supply intermediate goods for assemblers	28.7	33.0	26.9	21.3	9.3	16.0	25.0	37.5	23.3	26.3
Present market size	17.2	9.8	62.0	9.8	1.9	14.0	28.1	43.8	10.0	10.5
To export to the third countries	25.2	32.1	2.8	36.1	24.1	16.0	6.3	21.9	30.0	5.3
Cheap parts and components / low materials	30.0	9.8	2.8	16.4	11.1	16.0	12.5	9.4	10.0	15.8
To export to Japan	26.8	21.4	-	24.6	7.4	16.0	15.6	12.5	13.3	-
Human capital	11.0	8.0	16.7	-	33.3	6.0	25.0	25.0	10.0	-
R&D for the local market	9.9	6.3	27.8	4.9	5.6	30.0	6.3	9.4	3.3	15.8
Development of infrastructure	5.6	7.1	9.3	1.6	3.7	10.0	9.4	18.8	13.3	-
Investment incentives / deregulation measures	7.2	11.6	-	1.6	3.7	6.0	3.1	9.4	13.3	5.3
Investment by other firms in the same industry	9.1	7.1	4.6	4.9	3.7	-	3.1	9.4	10.0	-
Advancement of regional integration	1.3	5.4	-	6.6	-	4.0	-	-	13.3	10.5

Ranking	1	2	3	4	5	6	7	7	9	10	
Country	China	Thailand	U.S.	Indonesia	Vietnam	India	Korea	Taiwan	Malaysia	Brazil	
(b) Weak points											
	Number of firms ²⁾	356	89	73	60	43	43	28	31	28	15
Insufficient infrastructure	24.4	12.4	-	26.7	41.9	44.2	-	-	14.3	20.0	
Underdevelopment of legal system	46.3	4.5	-	8.3	46.5	32.6	-	-	7.1	-	
Nontransparency in the legal system	55.6	10.1	-	23.3	27.9	20.9	-	6.2	3.6	6.7	
Frequent and sudden changes in institutional arrangements	51.7	4.5	-	10.0	11.6	7.0	3.6	3.2	7.1	6.7	
Complicated taxation system	17.7	5.6	6.8	10.0	11.6	9.3	3.6	-	3.6	20.0	
Nontransparency in the implementation of taxation system	37.4	10.1	-	10.0	9.3	16.3	3.6	-	-	20.0	
Frequent and sudden changes in taxation system	36.5	3.4	-	3.3	11.6	2.3	3.6	3.2	-	13.3	
High import tariffs	19.9	13.5	2.7	8.3	11.6	9.3	3.6	-	-	33.3	
Insufficient deregulation for foreign capital	27.5	11.2	-	5.0	20.9	11.6	14.3	-	25.0	13.3	
Complicated administrative procedure	41.0	7.9	1.4	13.3	16.3	11.6	3.6	3.2	3.6	6.7	
Political and social environment	27.8	11.2	2.7	81.7	32.6	55.8	3.6	12.9	28.6	40.0	
Instability of local currency	8.7	46.1	9.6	58.3	27.9	20.9	17.9	16.1	17.9	46.7	
Difficulty in purchasing raw materials and parts and components in local market	20.5	20.2	5.5	18.3	25.6	18.6	10.7	6.5	7.1	6.7	
Underdevelopment of indogenous supporting industries	10.1	7.9	-	15.0	20.9	9.3	-	3.2	10.7	6.7	
Difficulty in local financing	15.4	10.1	8.2	13.3	11.6	14.0	14.3	3.2	7.1	-	
Harsh competition with other firms in the local market	27.5	25.8	68.5	23.3	9.3	18.6	64.3	54.8	25.0	6.7	
Insufficient human capital for managerial positions	25.8	30.3	24.7	30.0	16.3	16.3	17.9	16.1	25.0	6.7	
Low level of local labor	12.9	9.0	9.6	11.7	2.3	11.6	3.6	6.5	3.6	13.3	
Rising labor costs in host country	16.0	25.8	20.5	20.0	4.7	4.7	21.4	32.3	21.4	6.7	
Local labor problems	11.8	7.9	16.4	25.0	7.0	14.0	25.0	-	7.1	13.3	
Insufficient information on the host country	9.6	5.6	-	5.0	18.6	32.6	3.6	3.2	7.1	40.0	

Table 10 Investment climate: average measures of business costs, governance indicators, and doing business

	East Asia excl. China	China	Latin America
(a) Business costs			
Soundness of banks	4.7	4.0	4.4
Regulatory obstacles to business	4.3	3.5	4.6
Hidden trade barriers	4.8	4.9	4.1
Cost of importing foreign equipment	2.1	2.3	3
Technological sophistication	4.3	3.9	3.3
Quality of scientific research institutions	4.5	4.4	3.5
Quality of math and science education	4.8	4.1	3.3
Efficiency of legal framework	4.3	4.4	2.8
Property rights	5	4.1	3.8
Intellectual property protection	4.1	3.6	3.1
Burden of regulation	3.2	3.3	2.2
Extent of bureaucratic red tape	3	3.0	2.8
Irregular payments in exports & imports	4.6	5.1	4.3
Frequency of payments or bribes	4.6	5.2	3.5
Business cost of corruption	4.7	4.4	3.9
(b) Governance indicators			
Voice and accountability 2000	0.2	-1.4	0.2
Political stability 2000	0.2	0.3	-0.1
Government effectiveness 2000	0.7	0.2	-0.1
Regulatory quality 2000	0.7	-0.2	0.5
Rule of law 2000	0.6	-0.3	-0.2
Control of corruption 2000	0.4	-0.3	-0.2

Table 11 Trade and FDI-related problems and requests raised by Japanese firms in the selected Latin American countries (c

Mexico

- 1 Restriction on foreign ownership ratios, industries with foreign entry ban.
- 2 Leftover of local contents requirements, trade balance requirements.
- 3 Sudden changes and instability in PROSEC-applied products as a substitution of Maquiladora system.
- 4 Uncertainty of policies on transitions from Maquiladora related to permanent establishments, value added taxes, ar
- 5 Continual tariff increases, high tariffs.
- 6 Expansion of tariff differences between countries with RTAs and those without.
- 7 Excessive preferential arrangements for labor such as profit sharing and wage/retirement payment system.
- 8 Delay and complexity due to peculiar NOMS standard system.
- 9 Not enough capability of supporting industry, lack of supporting industry promotion policy.
- 10 Worsening security problem.

Chile

- 1 Expansion of tariff differences between countries with RTAs and those without.
- 2 Lack of tax treaty and investment treaty with Japan.
- 3 High value added tax and delay in tax rebate.
- 4 Insufficient infrastructure and high cost in port services.

Brazil

- 1 Domestic contents requirements, export requirements.
- 2 Large tariff differentials between intra-MERCOSUR and other trade.
- 3 Sudden changes in tariffs, import regulations and customs procedure, inefficiency in customs procedure.
- 4 Heavy taxes, complicated and frequently changed tax system.
- 5 Regulations on foreign remittances, restrictions on dividend payments, restrictions on credit amount.
- 6 Wage determination preferential to labor, employment customs, social security system, difficulty and delay in obta
- 7 Residence requirement for board members.
- 8 Insufficient infrastructure, lack of human capital, lack of supporting industry.
- 9 Large fluctuation in currency valuation and the existence of exchange rate risk.
- 10 Pervasive illegal imports and smuggling.

MERCOSUR

- 1 Losing competitiveness of Japanese products due to high common tariffs for nonmember countries.
- 2 Existence of both intra-regional and individual countries' contents requirements, non-transparency in local content
- 3 Large risk due to intra-regional exchange rate fluctuation.

5. Possible impact of FTAA and policy implication

- Concerns
 - Intra-regional tariff removal => restructuring of import-substituting industries
 - If MFN tariffs are kept high, investors from outside region will be in disadvantageous position (cf. Mexico), possibly reducing FDI.
- Expectations
 - FTAA and accompanied policy package would nurture the formulation of international prod./dist. networks in LA, accelerating FDI.

5. Possible impact of FTAA and policy implication (conti.)

- Policy measures beyond intra-regional tariff removal is essential.
 - MFN tariff reduction, particularly for intermediate goods for industrial production, so as to partially neutralize disadvantages for outside investors.
 - Policy package to stimulate the formation of networks, reducing service links, encourage the creation of critical mass of agglomeration.
- Room for learning from East Asian experience