2006 JETRO WHITE PAPER
ON
INTERNATIONAL TRADE AND FOREIGN DIRECT INVESTMENT

(Summary)

Japanese Corporate Activity in New Growth Markets
and the Emerging East Asian Free Trade Zone

JETRO

JAPAN EXTERNAL TRADE ORGANIZATION

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1. Economic, Trade and Investment Trends

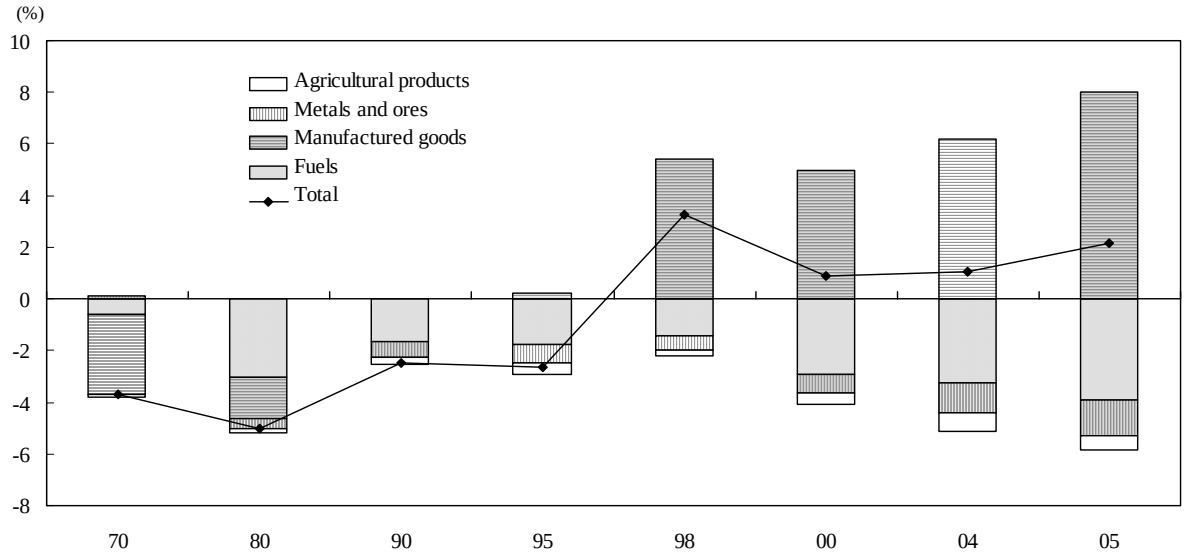
A. Global Economy

1) Near 5% Growth for Three Straight Years Expected

The global economy, after growing 5.3% in 2004, held at 4.8% in 2005 and is forecast to finish at 4.9% in 2006, a brisk pace of around 5% for three consecutive years. Developing economies grew 7.2%, the first time in 30 years they have grown at least 7% in two consecutive years. East Asian economies grew 8.3%, their third consecutive year at 8% or higher, and accounted for 37.4% of global economic growth.

The price of crude oil rose sharply. In the advanced economies, however, improved energy efficiency and productivity eased the inflationary pressure of higher oil prices. In oil-importing developing countries, brisk exports of manufactured goods offset higher fuel import costs, averting a worsening of their current account balances. In Asia, moves to reduce fuel subsidies should raise economic efficiency in the medium term, but this may generate short-term inflationary pressures, especially in Thailand and Indonesia.

Fig. 1 Asian current account balances (major fuel-importing developing countries)



Note: Figures based on GDP statistics for Bangladesh, China, India, Hong Kong, Pakistan, Philippines, ROK, Singapore and Thailand, but some years exclude data from some countries.
Sources: IMF, *IFS* and *WEO;* World Bank; WTO; and national trade statistics.

Fig. 2 Inflation rates when oil prices rise

(%, points)

	First oil shock		Second oil shock		Present	
	1974	Change	1980	Change	2005	Change
Industrialized economies	14.3	9.4	13.0	5.0	2.3	0.9
Non-oil-exporting developing economies	25.6	15.3	31.9	15.7	4.6	-0.7
Africa	13.7	8.0	16.5	1.1	6.3	-2.6
Asia	29.8	23.4	15.4	9.5	3.5	1.6
Central and South America	32.2	13.4	48.2	20.5	6.4	-2.7

Notes: 1. Changes (points) show 1974 compared with 1972, 1980 with 1978, and 2005 with 2002.
2. Figures exclude oil-exporting nations.
Source: IMF, *IFS*.

2) Global Exports Surpass US$10 Trillion

JETRO estimates that world trade (exports) rose 13.2% to $10,338.6 billion in 2005. Developing countries accounted for 42.7% of exports and 38.9% of imports, both records. Soaring crude oil prices raised the value of exports from petroleum-exporting countries by 36.7% (30.9% for countries in the Middle East). East Asian exports rose 17.4% to $2,136.6 billion, which accounted for 20.7% of global exports, the first time to exceed 20%. The BRIC countries (Brazil, Russia, India and China) achieved a 28.9% gain in exports of machinery, textiles and other manufactured goods, as well as energy and other primary-sector items. China recorded a 28.4% increase in exports to $762 billion and a 17.6% increase in imports to $660.1 billion.

Trade in services rose 10.8% to $2,414.7 billion. Chinese service exports jumped 30.8% and India's, led by IT software and related services, skyrocketed 76.2%.

Fig. 3 World trade indices

		Unit	2001	2002	2003	2004	2005
World merchandise trade (based on exports)		US$ billion	6,132	6,429	7,465	9,067	10,339
	Nominal growth rate	%	-3.9	4.8	16.1	21.5	13.2
	Real growth rate	%	0.0	4.0	6.0	12.6	7.5
	Export price growth rate	%	-3.8	0.8	10.2	8.8	5.6
World trade in services		US$ billion	1,495	1,601	1,834	2,180	2,415
	Nominal growth rate	%	0.2	7.2	14.5	18.8	10.8
World real GDP growth rate		%	2.6	3.1	4.1	5.3	4.8
Growth in mining and manufacturing industrial production index (industrialized economies)		%	-3.0	-0.5	1.1	3.4	1.9
Crude oil	Price (average)	US$/barrel	24.3	25.0	28.9	37.8	53.4
	Demand	Million barrels/day	77.4	77.8	79.4	82.5	83.6
Change in nominal effective exchange rate of U.S. dollar		%	5.9	-1.6	-12.3	-8.2	-1.5

Notes: 1. 2005 trade value and growth rates are JETRO estimates.
2. Real GDP growth rates based on purchasing power parity.
3. A negative change in the nominal effective exchange rate of the U.S. dollar indicates depreciation.
Sources: IMF, *IFS* and *WEO*; WTO; IEA; and national trade statistics.

Fig. 4 Trade in services (exports)

(%, US$ million)

	2002	2003	2004	2005	
					Value
Value of global service exports	7.2	14.5	18.8	10.8	2,414,700
Transportation	4.5	13.4	23.6	11.4	563,200
Travel	4.7	9.9	18.0	10.1	697,700
Other services	10.1	18.1	17.1	10.9	1,153,800

Source: WTO.

Fig. 5 World trade (exports) in 2005

(US$ million, %)

	Value	Growth rate	Share	Contribution
Total value	10,338,610	13.2	100.0	100.0
Machinery and equipment	4,352,140	9.7	42.1	32.1
General machinery	1,410,046	9.6	13.6	10.3
Electrical equipment	1,409,960	11.3	13.6	11.9
Transport equipment	1,176,579	7.4	11.4	6.7
Automobiles	582,126	6.5	5.6	3.0
Passenger vehicles	484,453	5.7	4.7	2.2
Automotive parts	255,236	7.9	2.5	1.6
Precision instruments	354,183	11.2	3.4	3.0
Chemicals	1,332,859	12.1	12.9	12.0
Industrial chemicals	895,434	11.2	8.7	7.5
Pharmaceuticals and medical supplies	251,285	11.3	2.4	2.1
Plastics and rubber	437,425	14.0	4.2	4.5
Foodstuffs	622,639	8.4	6.0	4.0
Grains	41,541	-2.2	0.4	-0.1
Processed food products	274,801	8.5	2.7	1.8
Oils, fats, and other animal and vegetable products	71,071	2.5	0.7	0.1
Miscellaneous manufactured goods	309,766	9.7	3.0	2.3
Iron ore	28,435	62.0	0.3	0.9
Mineral fuels, etc.	1,238,855	39.0	12.0	28.9
Mineral fuels	1,185,272	38.7	11.5	27.5
LNG	38,355	30.8	0.4	0.8
Petroleum and petroleum products	992,904	41.5	9.6	24.2
Crude oil	655,803	39.1	6.3	15.3
Textiles and textile products	506,375	4.8	4.9	1.9
Synthetic fibers and textiles	64,519	1.6	0.6	0.1
Clothing	272,771	6.0	2.6	1.3
Knit products	126,622	5.2	1.2	0.5
Cloth	146,149	6.7	1.4	0.8
Base metals and base metal products	762,166	15.1	7.4	8.3
Steel	454,181	15.1	4.4	5.0
Primary steel products	284,086	13.2	2.7	2.8
Steel products	170,095	18.5	1.6	2.2
IT products				
Computers and peripherals	473,101	8.7	4.6	3.1
Computers and peripherals	279,646	8.1	2.7	1.7
Parts for computers and peripherals	193,455	9.6	1.9	1.4
Office equipment	18,067	15.0	0.2	0.2
Telecommunications equipment	231,529	24.2	2.2	3.8
Semiconductors and electronic components	368,174	5.2	3.6	1.5
CRTs and semiconductors	64,824	4.1	0.6	0.2
Integrated circuits	303,349	5.5	2.9	1.3
Other electronic components	303,980	10.3	2.9	2.4
Video equipment	113,668	7.4	1.1	0.7
Audio equipment	14,618	47.0	0.1	0.4
Measuring and testing equipment	131,336	6.1	1.3	0.6
IT parts	865,609	7.9	8.4	5.3
IT finished products	788,864	12.6	7.6	7.4
Total IT equipment	1,654,473	10.1	16.0	12.6

Source: National trade statistics.

3) FDI Up 23.2% and Cross-Border M&A Jump 84.9%

Global inward direct investment on an international balance of payments basis increased 23.2% to $964.7 billion. Investment in China rose 44.7% to $79.1 billion. Investment in East Asia was up 24.3% to $152.5 billion, or 15.8% of the global total.

Outward direct investment declined 8.2% to $759.6 billion. This decline was due largely to a sharp reduction in U.S. outward investment, the result of U.S. foreign subsidiaries repatriating large amounts of earnings back to the U.S.A. to reduce tax obligations. U.S. corporations' reinvestment shifted from a $157.3 billion outflow in 2004 to an $11.2 billion inflow in 2005.

Cross-border merger and acquisition transactions increased dramatically by 84.9% to $819.3 billion, led by Europe. Notable were the $80.3 billion restructuring of Royal Dutch Shell and vigorous activity in the electric power, mobile phone and banking sectors. The value of EU25 buyouts increased 130% to $498.3 billion, accounting for 60% of global cross-border M&A.

Fig. 6 FDI of major economies (net flows based on balance of payments)

(US$ million, %)

	Inward FDI					Outward FDI				
	2004	2005	Growth rate	Contribution	Share	2004	2005	Growth rate	Contribution	Share
U.S.A.	133,162	109,754	-17.6	-3.0	11.4	244,128	9,072	-96.3	-28.4	1.2
Canada	1,533	33,822	2105.7	4.1	3.5	43,254	34,083	-21.2	-1.1	4.5
EU25	308,897	493,175	59.7	23.5	51.1	379,300	575,297	51.7	23.7	75.7
EU15	280,469	458,487	63.5	22.7	47.5	374,719	569,430	52.0	23.5	75.0
Luxembourg	77,215	70,638	-8.5	-0.8	7.3	81,664	80,703	-1.2	-0.1	10.6
France	54,095	76,104	40.7	2.8	7.9	18,297	50,185	174.3	3.9	6.6
Germany	-15,114	32,662	n.a.	6.1	3.4	1,883	45,633	2323.6	5.3	6.0
Italy	16,815	19,921	18.5	0.4	2.1	19,262	41,754	116.8	2.7	5.5
Netherlands	442	44,277	9916.6	5.6	4.6	17,282	120,830	599.2	12.5	15.9
Spain	24,761	22,987	-7.2	-0.2	2.4	60,532	38,772	-35.9	-2.6	5.1
Sweden	12,609	13,389	6.2	0.1	1.4	20,985	25,938	23.6	0.6	3.4
UK	77,659	159,501	105.4	10.5	16.5	98,559	102,799	4.3	0.5	13.5
10 new EU members	28,429	34,687	22.0	0.8	3.6	4,581	5,867	28.1	0.2	0.8
Czech	4,974	10,991	121.0	0.8	1.1	1,014	856	-15.6	0.0	0.1
Hungary	4,661	6,485	39.1	0.2	0.7	1,111	1,282	15.5	0.0	0.2
Poland	12,873	8,241	-36.0	-0.6	0.9	794	1,525	92.1	0.1	0.2
Australia	42,022	-36,903	n.a.	-10.1	n.a.	17,483	-39,889	n.a.	-6.9	n.a.
Japan	7,809	3,223	-58.7	-0.6	0.3	30,968	45,461	46.8	1.8	6.0
East Asia	122,685	152,452	24.3	3.8	15.8	70,611	63,165	-10.5	-0.9	8.3
China	54,936	79,127	44.0	3.1	8.2	1,805	11,306	526.4	1.1	1.5
Asian NIEs	60,000	61,952	3.3	0.2	6.4	66,041	48,442	-26.6	-2.1	6.4
Rep. of Korea	9,246	4,339	-53.1	-0.6	0.4	4,658	4,312	-7.4	0.0	0.6
Taiwan	1,898	1,625	-14.4	0.0	0.2	7,145	6,028	-15.6	-0.1	0.8
Hong Kong	34,036	35,905	5.5	0.2	3.7	45,726	32,582	-28.7	-1.6	4.3
Singapore	14,820	20,083	35.5	0.7	2.1	8,512	5,519	-35.2	-0.4	0.7
ASEAN4	7,749	11,374	46.8	0.5	1.2	2,765	3,417	23.6	0.1	0.4
Thailand	1,414	4,008	183.4	0.3	0.4	125	284	126.9	0.0	0.0
Malaysia	4,624	3,976	-14.0	-0.1	0.4	2,061	2,971	44.2	0.1	0.4
Indonesia	1,023	2,258	120.8	0.2	0.2	n.a.	n.a.	n.a.	n.a.	n.a.
Philippines	688	1,132	64.5	0.1	0.1	579	162	-72.0	-0.1	0.0
India	5,474	6,598	20.5	0.1	0.7	2,024	1,364	-32.6	-0.1	0.2
Latin America (20)	60,658	67,093	10.6	0.8	7.0	16,192	18,068	11.6	0.2	2.4
Mexico	18,674	18,055	-3.3	-0.1	1.9	4,432	6,171	39.2	0.2	0.8
Brazil	18,146	15,066	-17.0	-0.4	1.6	9,807	2,517	-74.3	-0.9	0.3
Argentina	4,274	4,730	10.7	0.1	0.5	442	1,151	160.5	0.1	0.2
Colombia	3,117	10,378	232.9	0.9	1.1	142	4,623	3145.6	0.5	0.6
Venezuela	1,144	2,957	158.5	0.2	0.3	-158	1,460	n.a.	0.2	0.2
Russia	15,444	14,183	-8.2	-0.2	1.5	13,782	12,393	-10.1	-0.2	1.6
Turkey	2,837	9,686	241.4	0.9	1.0	859	1,048	22.0	0.0	0.1
Israel	1,757	5,585	217.9	0.5	0.6	4,544	2,491	-45.2	-0.2	0.3
South Africa	798	6,382	699.8	0.7	0.7	1,350	68	-95.0	-0.2	0.0
World	782,839	964,744	23.2	23.2	100.0	827,368	759,643	-8.2	-8.2	100.0

Notes: 1. JETRO estimates for the world.
2. The ten new EU members are Czech, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus, and Malta.
3. The twenty Central and South American nations are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominica, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad, Tobago, Uruguay, and Venezuela.
Sources: IMF; OECD; UN ECLAC; and national and regional balance of payment statistics.

Fig. 7 World cross-border M&A (by nation)

(US$ million)

	Sellers			Purchasers		
	2003	2004	2005	2003	2004	2005
World	331,271	443,012	819,280	331,271	443,012	819,280
U.S.A.	72,408	85,143	108,643	91,197	125,039	154,010
EU25	147,357	220,990	498,279	146,704	195,655	459,540
Japan	12,530	10,252	2,833	7,398	5,989	11,009
East Asia	19,691	24,901	48,837	16,329	21,224	35,043
China	4,856	8,814	13,720	4,651	2,290	8,516
Asian NIEs	12,195	11,603	25,305	7,765	16,078	21,052
ASEAN4	2,640	4,484	9,812	3,913	2,856	5,475

Note: Data as of July 7, 2006.
Source: Thomson Financial.

Fig. 8 World cross-border M&A (by industry)

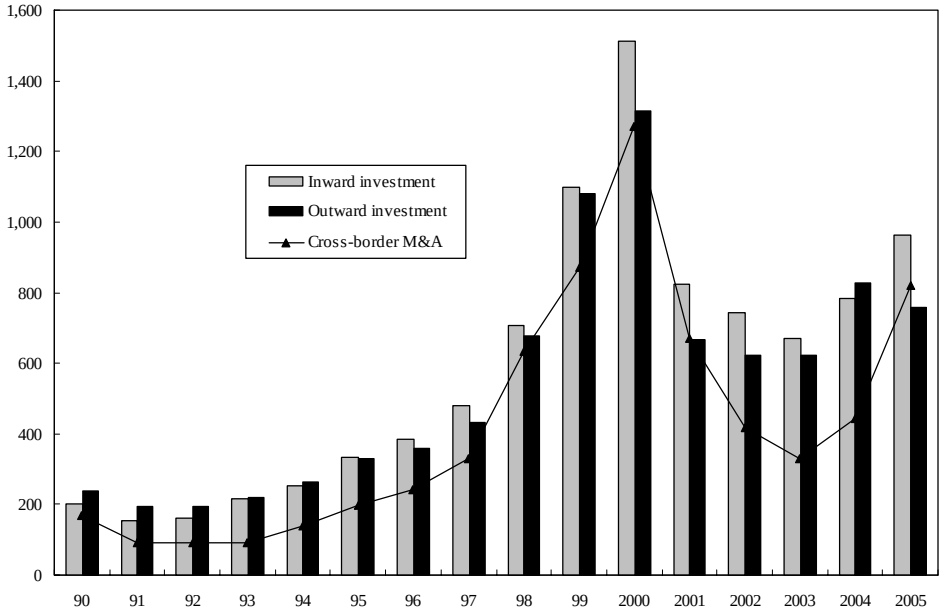
(US$ million)

	2005	2006
Total	819,280	415,046
Primary industries	134,620	21,602
Petroleum, natural gas (petroleum refining)	118,894	11,149
Manufacturing	236,017	96,387
Service	448,642	297,057
Power, gas, water	65,278	6,286
Transportation	35,577	22,282
Telecommunications	71,060	85,222
Construction	6,267	19,239
Retail	32,271	19,616
Real estate leasing, brokerage	54,453	24,678
Finance, insurance	102,803	71,089
Banking, bank holding companies	59,531	34,875
Investment, security, trust	22,558	14,137
Insurance	15,103	17,649
Lodging (including casinos)	7,498	9,920
Other services	73,436	38,726

Note: Based on industries of sellers. Data as of July 7, 2006.
Source: Thomson Financial.

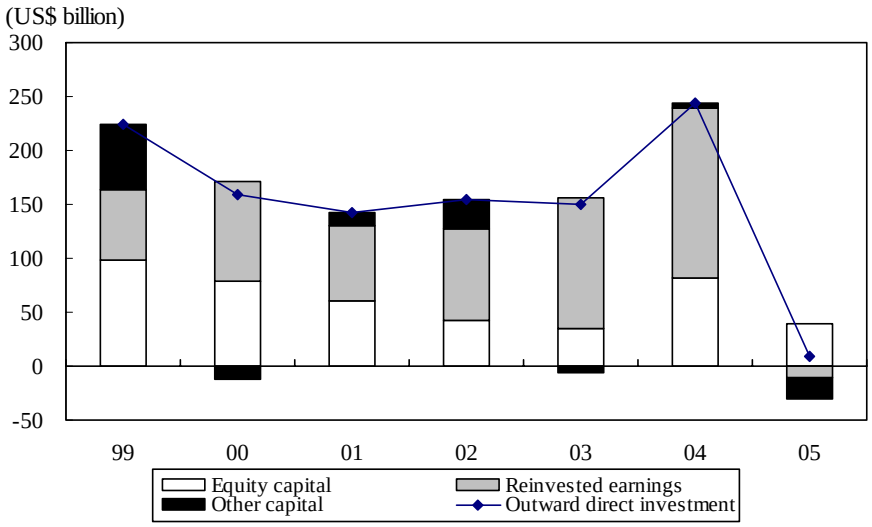
Fig. 9 Global foreign direct investment and cross-border M&A

(US$ billion)



Note: 2005 data on inward investment are JETRO estimates. M&A figures are completed deals.
Sources: Prepared from IMF national trade statistics and Thomson Financial data.

Fig. 10 U.S. outward direct investment



Note: Current prices
Source: Prepared by JETRO from U.S. Department of Commerce data

B. Japanese Economy

1) Exports Rise 5.9% and Imports Jump 14.1%

Japanese exports (customs basis) rose 5.9% to $598.2 billion. Imports rose 14.1% to $518.6 billion. On a volume basis, exports grew 0.8% and imports 2.9%, down sharply from 10.6% and 7.0%, respectively, in 2004. Exports of electronic components to Asian NIEs and ASEAN countries were slowed by efforts to reduce inventory surpluses worldwide in the IT industry. This was offset, however, by healthy exports of automobiles to the United States.

Although the value of crude oil imports rose as prices soared, volume showed little change from the previous year. IT imports from East Asia increased, reflecting growing domestic demand.

Exports to the United States increased 6.4% to $134.9 billion, while imports from the United States rose 3.3% to $64.5 billion. Exports to East Asia rose 5.5% to $279.4 billion, while imports from East Asia were up 11.9% to $219.3 billion. Exports to China rose 8.8% to $80.3 billion, while imports from China climbed 15.8% to $109.1 billion.

Fig. 11 Trends in Japanese trade

(US$ million, %)

	2004	2005	2005				2006
			Q1	Q2	Q3	Q4	Q1
Exports	565,039	598,215	144,301	147,373	150,649	155,892	151,243
YoY change (%)	20.3	5.9	7.0	6.5	6.3	3.9	4.8
Imports	454,669	518,638	121,480	127,887	133,325	135,946	137,887
YoY change (%)	19.2	14.1	13.7	16.6	15.8	10.5	13.5
Trade balance	110,370	79,577	22,821	19,486	17,324	19,947	13,356
YoY change (%)	22,035	-30,792	-5,164	-9,256	-9,302	-7,070	-9,465
Export volume index	113.4	114.4	107.1	112.6	116.0	121.4	119.2
YoY change (%)	10.6	0.8	-2.0	-1.0	0.9	5.1	11.2
Import volume index	114.6	117.9	114.8	116.6	119.1	120.8	121.0
YoY change (%)	7.0	2.9	3.1	3.6	4.1	0.7	5.4
Crude oil import price (US$/barrel)	36.4	51.1	40.7	49.7	56.1	57.3	59.5
YoY change (%)	24.5	40.5	29.6	42.6	45.9	41.3	46.1
Ratio of oil imports	12.3	15.4	13.0	14.2	17.1	17.1	17.5
Ratio of manufactured imports	61.3	58.6	60.8	58.9	57.5	57.2	56.5
Exchange rate (¥/$ avg.)	108.2	110.2	104.5	107.6	111.2	117.3	116.9
YoY change (%)	7.2	-1.8	2.6	1.9	-1.2	-9.7	-10.6
Real GDP growth rate	2.3	2.6	1.3	1.3	0.3	1.1	0.8

Notes: 1. The base year for volume indices is 2000.

2. Exchange rates are the interbank central rate averages for the period.

3. Quarterly growth rates are YoY comparisons.

4. Real GDP growth rates per quarter are seasonally adjusted YoY comparisons

Sources: Ministry of Finance, *Trade Statistics;* Cabinet Office, *The System of National Accounts* ; and Bank of Japan, *Economic Statistics Monthly*

Fig. 12 Japan's import/export trends with major trading partners

(US$ million, %)

			2004	2005	2005				2006
					Q1	Q2	Q3	Q4	Q1
U.S.A.	Exports	Value	126,839	134,889	32,776	33,297	33,144	35,672	34,428
		YoY change	9.9	6.4	7.2	7.4	4.9	5.9	5.0
	Imports	Value	62,435	64,497	15,312	16,673	16,472	16,041	16,392
		YoY change	6.4	3.3	2.0	2.8	8.2	0.4	7.1
	Export volume YoY change		3.6	2.1	-0.1	1.5	1.7	5.0	9.3
	Import volume YoY change		9.0	1.6	1.3	1.3	7.2	-2.5	0.2
EU25	Exports	Value	88,903	88,036	22,637	21,629	21,187	22,583	22,627
		YoY change	18.4	-1.0	-1.1	1.5	0.3	-4.2	0.0
	Imports	Value	57,796	59,066	15,134	14,870	14,532	14,529	14,864
		YoY change	16.1	2.2	2.1	7.8	3.6	-4.1	-1.8
	Export volume YoY change		7.3	-5.2	-10.3	-6.4	-2.8	-1.5	3.8
	Import volume YoY change		5.0	0.2	-1.7	1.2	2.1	-0.6	1.8
East Asia9	Exports	Value	264,762	279,429	66,174	69,456	71,591	72,208	67,928
		YoY change	25.5	5.5	7.4	5.8	5.5	3.7	2.7
	Imports	Value	195,919	219,305	52,974	54,499	55,269	56,564	56,789
		YoY change	21.1	11.9	16.5	15.0	10.9	6.3	7.2
Asian NIEs	Exports	Value	139,490	145,467	35,122	36,366	36,993	36,987	35,258
		YoY change	26.3	4.3	6.7	5.1	3.7	1.9	0.4
	Imports	Value	46,600	51,048	12,239	12,749	12,747	13,313	13,867
		YoY change	20.0	9.5	9.0	9.4	10.8	8.9	13.3
	Export volume YoY change		12.5	-5.5	-3.6	-7.5	-8.1	-2.7	5.1
	Import volume YoY change		4.4	5.8	-3.5	-3.0	9.4	18.8	28.8
ASEAN4	Exports	Value	51,454	53,622	13,066	13,888	13,593	13,075	12,343
		YoY change	18.9	4.2	8.1	9.9	1.8	-2.2	-5.5
	Imports	Value	55,091	59,153	14,631	14,725	14,982	14,815	15,285
		YoY change	15.4	7.4	12.6	11.1	4.9	1.8	4.5
	Export volume YoY change*		11.3	1.4	-1.0	3.0	1.2	2.5	3.4
	Import volume YoY change*		3.1	-1.6	3.7	-0.1	-4.6	-4.4	-1.9
China	Exports	Value	73,818	80,340	17,986	19,202	21,005	22,146	20,327
		YoY change	29.0	8.8	8.5	4.2	11.5	10.9	13.0
	Imports	Value	94,227	109,105	26,104	27,025	27,540	28,436	27,638
		YoY change	25.3	15.8	22.8	20.3	14.5	7.5	5.9
	Export volume YoY change		16.5	2.4	-5.0	-4.4	4.7	13.3	19.0
	Import volume YoY change		13.4	11.2	12.0	15.4	10.3	7.5	8.8

Notes: 1. The Asian NIEs are Korea, Taiwan, Hong Kong, and Singapore.

2. The ASEAN4 are Indonesia, Thailand, the Philippines, and Malaysia.

3. The figures for the ASEAN10 import and export volume YoY change were used for the ASEAN4.

Source: Ministry of Finance, *Trade Statistics*.

Fig. 13 Japanese exports by product (2005)

(US$ million, %)

	World		U.S.A.		EU25		China		Asian NIEs		ASEAN4	
	Value	YoY	Value	YoY	Value	YoY	Value	YoY	Value	YoY	Value	YoY
Total value	598,215	5.9	134,889	6.4	88,036	-1.0	80,340	8.8	145,467	4.3	53,622	4.2
Foodstuffs	2,894	10.6	510	12.6	111	-2.0	353	19.9	1,401	10.3	216	30.4
Raw materials	6,757	15.5	329	7.7	484	-1.1	2,711	33.7	2,249	8.5	562	4.9
Mineral fuels	4,243	97.8	660	99.7	398	433.5	1,216	97.4	1,094	69.1	133	-36.4
Chemicals	53,273	10.4	6,931	-0.1	6,537	2.3	10,466	14.3	20,286	16.1	4,843	7.7
Basic manufactures	67,432	11.7	7,862	6.8	5,348	6.4	13,246	10.2	20,174	10.6	10,375	16.5
Iron and steel	27,724	19.1	1,626	34.6	668	12.2	5,649	15.7	9,489	11.7	5,707	29.7
General machinery	121,776	4.6	30,433	8.1	21,940	5.6	17,080	0.3	25,411	-4.8	12,272	10.0
Electrical equipment	132,459	-0.2	23,547	0.9	20,716	-6.9	20,780	7.2	41,676	-3.2	14,415	-1.9
Transportation equipment	138,524	6.3	49,803	8.4	21,857	-7.8	4,040	-3.4	8,206	17.2	6,063	-2.8
Automobiles	90,467	6.3	36,209	9.2	14,909	-9.1	1,291	-21.4	2,643	11.4	2,373	-11.4
Other	70,858	6.9	14,813	5.7	10,645	5.5	10,447	14.7	24,971	8.3	4,743	-6.0

Source: Ministry of Finance, *Trade Statistics.*

Fig. 14 Japanese imports by product (2005)

(US$ million, %)

	World		U.S.A.		EU25		China		Asian NIEs		ASEAN4	
	Value	YoY	Value	YoY	Value	YoY	Value	YoY	Value	YoY	Value	YoY
Total value	518,638	14.1	64,497	3.3	59,066	2.2	109,105	15.8	51,048	9.5	59,153	7.4
Foodstuffs	50,710	3.5	13,377	3.5	5,558	-2.4	7,903	6.8	2,699	-7.0	4,342	5.7
Raw materials	31,945	12.4	3,578	-4.2	2,052	2.3	1,688	9.0	997	13.4	5,672	18.9
Mineral fuels	132,204	34.0	1,218	-17.8	141	6.1	3,301	1.8	3,674	9.5	15,938	19.2
Chemicals	39,445	11.9	8,087	3.7	14,252	6.4	4,281	40.8	4,769	21.6	2,416	19.5
Basic manufactured goods	49,437	10.1	3,643	9.5	5,322	1.5	13,190	18.3	6,666	23.5	6,105	1.9
General machinery	51,661	8.1	10,240	1.3	7,300	6.9	18,696	23.6	7,955	-3.2	5,388	-5.7
Electrical equipment	67,395	6.5	10,526	0.4	5,722	1.3	20,851	18.8	14,875	4.4	12,941	-1.2
Transportation equipment	18,778	5.7	5,658	7.2	8,207	-2.0	1,575	23.3	781	6.5	749	10.5
Other	77,061	10.7	8,172	11.9	10,511	0.4	37,620	11.0	8,633	24.2	5,603	5.0

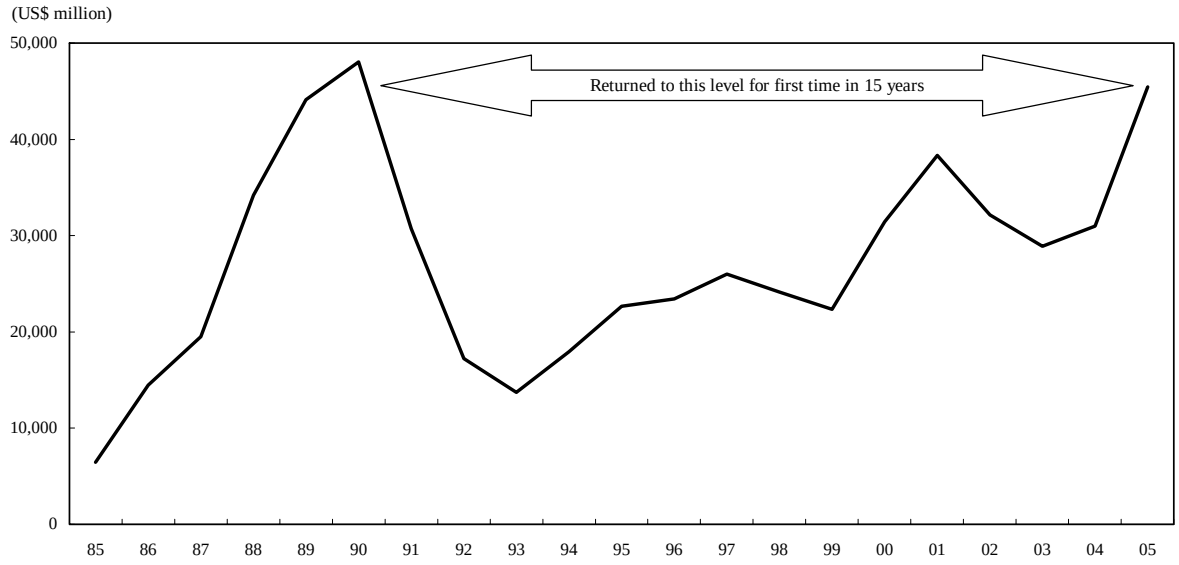
Source: Ministry of Finance, *Trade Statistics.*

2) Outward FDI Reaches 15-Year High

Japan's outward foreign direct investment (balance of payments basis) rose 46.8% to $45.5 billion, the highest level since the early '90s. Manufacturing investment accounted for more than half at $26.1 billion.

Strong sales of autos in the U.S. drove increased investment in the automotive sector. Investment was also active in East Asia, fueled by expectations of further market expansion. In the financial and insurance sector, direct investment was up 53.4% to $16.2 billion, of which 61.1%, or $12.1 billion, was invested in the United States.

Fig. 15 Trends in Japanese FDI (based on balance of payments)



Notes: These data lack strict continuity due to differences in yen-dollar exchange rate calculation methods, changing definitions of direct investment, and other factors. For 1985-1994, dollar-denominated published values were used. For 1995-2004, yen-denominated published values were converted to dollars for each six month period using the average Bank of Japan interbank rate for the period. For 2005, the conversions were calculated on a quarterly basis.
Sources: Ministry of Finance, *Balance of Payments Statistics*; Bank of Japan, *Foreign Exchange Rates*; and others.

Fig. 16 Japan's outward FDI, by industry (balance of payments, net and flow)

(US$ million, %)

	2005	
		Share
Manufacturing	26,146	57.5
Foodstuffs	1,685	3.7
Chemicals and pharmaceuticals	3,363	7.4
Petroleum	531	1.2
Ferrous and non-ferrous metals	1,331	2.9
General machinery	1,296	2.9
Electrical machinery	4,377	9.6
Transportation equipment	8,611	18.9
Precision machinery	1,419	3.1
Non-manufacturing	19,315	42.5
Mining	1,372	3.0
Construction	148	0.3
Transportation	824	1.8
Communications	1,712	3.8
Wholesale and retail	4,623	10.2
Financial, insurance	9,227	20.3
Real estate	-851	n.a.
Services	1,086	2.4
Total	45,461	100.0

Notes: 1. Yen amounts converted to U.S. dollars using Bank of Japan average interbank rate for each period.
2. "-" indicates net outflow.
Sources: Ministry of Finance, *Balance of Payments Statistics*; and Bank of Japan, *Foreign Exchange Rates.*

Fig. 17 Japan's outward FDI, by country/region (balance of payments, net and flow)

(US$ million, %)

	2004	2005	Share	Growth rate
Asia	10,552	16188	35.6	53.4
China	5,868	6575	14.5	12.0
ASEAN4	2,546	4276	9.4	67.9
Thailand	1,874	2125	4.7	13.4
Indonesia	503	1185	2.6	135.7
Hong Kong	488	1782	3.9	265.1
ROK	771	1736	3.8	125.0
India	139	266	0.6	91.6
North America	7,570	13168	29.0	73.9
U.S.A.	7,527	12126	26.7	61.1
Central and South America	3,138	6402	14.1	104.0
Brazil	-66	953	2.1	n.a.
Cayman Islands	2,748	3915	8.6	42.4
Oceania	1,862	943	2.1	-49.3
Western Europe	7,088	7509	16.5	5.9
Eastern Europe, Russia, etc.	437	721	1.6	65.0
Middle East	-62	542	1.2	n.a.
Africa	381	25	0.1	-93.5
World	30,968	45461	100.0	46.8
For reference:				
EU	7,334	7872	17.3	7.3

Notes: 1. For 2004, yen-denominated published values were converted to dollars for each six month period using the average Bank of Japan interbank rate for the period; for 2005, the conversions were calculated on a quarterly basis.
2. "-" indicates a net outflow.
3. Growth rates are YoY comparisons.
4. From the second quarter of 2004, the EU data include 10 new member states.
5. "World" includes countries not included in the regional classifications; that total is therefore not necessarily equal to the sum of the regional subtotals.
Sources: Ministry of Finance, *Balance of Payments Statistics*; and Bank of Japan, *Foreign Exchange Rates*.

Fig. 18 Foreign investment by major Japanese auto makers (announcements since January 2005)

Company	Region	When announced	Amount invested (approximate)	
Toyota	NAFTA	February 2006	US$950 million	Expanding SUV production facilities with second Canadian plant; annual output of 150,000 vehicles.
		May 2005	US$120 million	Expanding automatic transmission production capacity at its West Virginia, U.S.A., plant
	China	October 2005	US$52.99 million	Adding a new production line at Guangqi Toyota Engine, increasing engine manufacturing capacity to 500,000 engines annually
	ASEAN	April 2005	US$41 billion	Expanding manufacturing capacity of Toyota Motor Thailand, its auto manufacturing and sales company in Thailand
	Other	April 2005	¥27 billion	Beginning production of a new pickup truck and IMV series SUV in South Africa
		April 2005	¥15 billion	Decision to build a new plant in St. Petersburg, its first in Russia
Honda	NAFTA	May 2005	US$100 million	Building a new transmission plant in the state of Georgia, U.S.A.
		June 2006	US$550 million	Building a four-wheeled-vehicle plant with annual manufacturing capacity of 200,000 vehicles
	China	October 2005	US$98 million	Established a company to manufacture powertrain components in Guangdong; it will produce driveshafts and engine parts, and supply them to Honda's four-wheeled-vehicle assembly companies in China.
	ASEAN	July 2005	¥4 billion	Expanding the manufacturing capacity of its Thai four-wheeled-vehicle manufacturing and sales company's engine plant from 150,000 to 300,000 engines annually.
		September 2005	US$140 million	A third two-wheeled-vehicle plant goes on line in Indonesia; total output of the three plants is 15 million units.
	Other	November 2005	US$100 million	Expanding production facilities at the Sumare, Sao Paolo, Brazil plant, to raise manufacturing capacity to over 80,000 vehicles by early 2007 and to 100,000 in 2008.
Nissan	NAFTA	September 2005	US$1.3 billion	Beginning production of the Bertha, a new compact model, in 2006 at its Mexico plant; annual manufacturing capacity will rise from 200,000 vehicles currently to 350,000 vehicles in 2007.
	China	September 2005	¥30 billion	Expanding automobile production line at its Huadu, Guangdong, plant by 2008, doubling manufacturing capacity to 200,000 vehicles.
	ASEAN	May 2005	¥50 billion	Overall renewal of its Thai production facilities, adding a new pickup truck gearbox assembly line and updating older presses, painting robots and other production equipment for the entire process.
	Other	April 2006	US$200 million	Building a new auto assembly plant in St. Petersburg, Russia, with planned manufacturing capacity of 50,000 vehicles annually.

Sources: *Japan Corporate Watcher*; auto manufacturers' press releases; newspapers; and *JETRO Daily*.

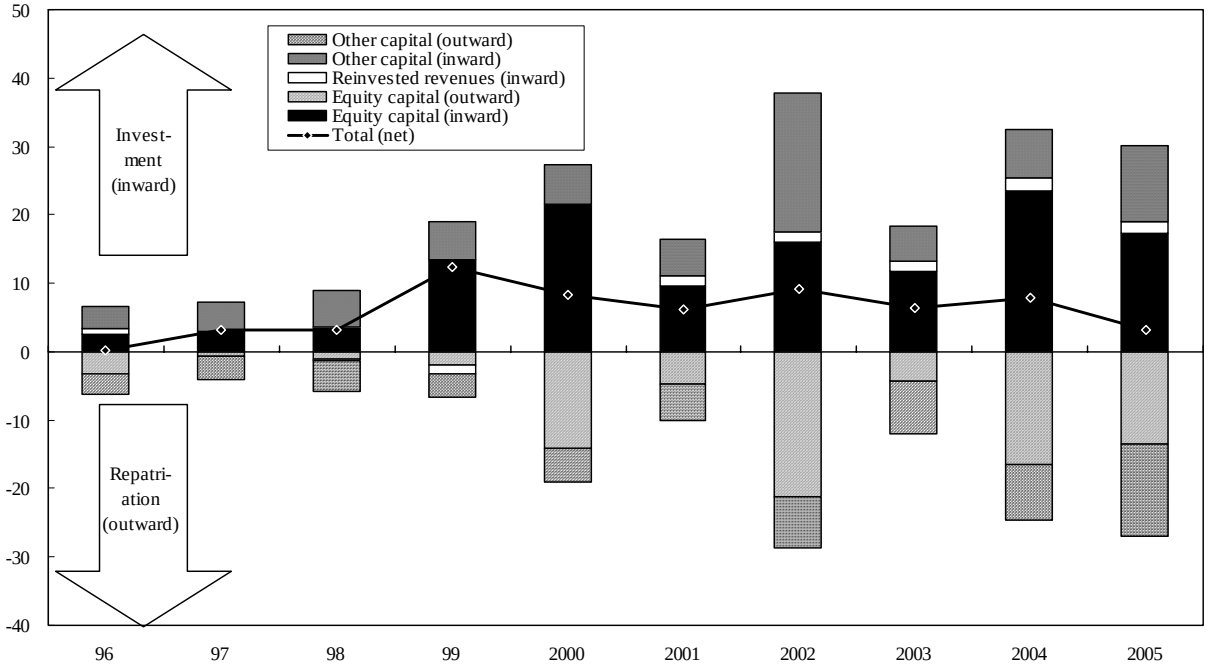
3) Inward FDI Remains High Amidst Brisk Capital Outflows

Foreign direct investment (FDI) entering Japan slumped 7.1% to $30.1 billion. Capital outflows increased 9.3% to $26.9 billion, resulting in a net inflow of $3.2 billion. Capital outflows were led by foreign funds that recouped their investments in the restructuring of Japanese firms once these firms had gotten back on track (such as Lone Star Group's sale of shares in Tokyo Star Bank). Another factor was the withdrawal of foreign firms from the Japanese market, such as GM's dissolution of its capital tie-up with Fujitsu Heavy Industry and the withdrawal of French retailer Carrefour.

Inward FDI was supported by large investments in the shipping, financial services and retail sectors. Leading examples include Cerberus' investment in the financial restructuring of the Kokusai Kogyo Group, the incorporation of Deutsche Securities and Wal-Mart's increased stake in Seiyu.

Fig. 19 Japan's direct inward investment

(US$ billion)



Note: For 2004, yen-denominated published values were converted to dollars for each six month period using the average Bank of Japan interbank rate for the period; for 2005, conversions were calculated on a quarterly basis.
Sources: Ministry of Finance, *Balance of Payments Statistics*; and Bank of Japan, *Foreign Exchange Rates*.

Fig. 20 Japan's inward FDI, by country/region (balance of payments, net and flow)

(US$ million, %)

	2004	2005		
			Share	Growth rate
Asia	996	1,565	48.5	57.1
China	-10	11	0.4	n.a.
ASEAN10	394	592	18.4	50.3
Singapore	391	598	18.6	53.1
Asian NIEs3	621	965	29.9	55.5
Hong Kong	298	960	29.8	222.1
North America	2,249	-636	n.a.	n.a.
U.S.A.	1,370	308	9.6	-77.5
Canada	881	-944	n.a.	n.a.
Central and South America	-1,131	1,278	39.6	n.a.
Cayman Islands	-771	1,069	33.2	n.a.
British Virgin Islands	n.a.	205	6.4	n,a.
Oceania	-3	-114	n.a.	n.a.
Western Europe	5,685	1,123	34.8	-80.3
Germany	1,162	237	7.4	-79.6
Netherlands	3,670	2,541	78.8	-30.8
Belgium	-418	-1,188	n.a.	n.a.
Luxembourg	261	363	11.3	39.2
Switzerland	105	-748	n.a.	n.a.
Eastern Europe, Russia, etc.	-1	0	0.0	n.a.
Middle East	3	9	0.3	218.3
Africa	-13	1	0.0	n.a.
World	7,809	3,223	100.0	-58.7
For reference:				
EU	5,557	1,858	57.6	-66.6

Notes: 1. For 2004, yen-denominated published values were converted to dollars for each six month period using the average Bank of Japan interbank rate for the period; for 2005, the conversions were calculated on a quarterly basis.
2. "-" indicates a net outflow.
3. Growth rates are YoY comparisons.
4. From the second quarter of 2004, the EU data include 10 new member states.
5. "World" includes countries not included in the regional classifications; that total is therefore not necessarily equal to the sum of the regional subtotals.

Sources: Ministry of Finance, *Balance of Payments Statistics;* and Bank of Japan, *Foreign Exchange Rates*.

Fig. 21 Japan's inward FDI, by industry (balance of payments basis, net and flow)

(US$ million, %)

	2005	
		Share
Manufacturing	-2,191	n.a.
Foodstuffs	-211	n.a.
Textiles	188	5.8
Lumber and pulp	-22	n.a.
Chemicals and phamaceuticals	-1,168	n.a.
Petroleum	-44	n.a.
Rubber and leather	1	0.0
Glass and ceramics	103	3.2
Iron, non-ferrous and metals	-34	n.a.
General machinery	164	5.1
Electric machinery	-1,195	n.a.
Transportation machinery	32	1.0
Precision machinery	-59	n.a.
Non-manufacturing	5,414	168.0
Farming and forestry	-1	n.a.
Fisheries and marine products	0	0.0
Mining	0	0.0
Construction	41	1.3
Transportation	2,108	65.4
Communications	912	28.3
Wholesale and retail	1,157	35.9
Finance and insurance	645	20.0
Real estate	15	0.5
Services	178	5.5
Total	3,223	100.0

Notes: 1.The average Bank of Japan interbank rate for the period was used to convert yen amounts to U.S. dollars.
2. "-" indicates a net outflow.
3. "0" indicates a sum less than US$1 million.

Sources: Ministry of Finance, *Balance of Payments Statistics; and* Bank of Japan, *Foreign Exchange Rates*.

Fig. 22 Buyouts, etc. of foreign ownership in Japanese firms

Date	Target Name	Industry	Acquiror Name	Industry	US$ million	Description
January 2005	Asahi Security Co Ltd.,	Consumer products and services	The Carlyle Group	Investment	190	Sold to Toyota Industries Corporation
February 2005	Cable & Wireless IDC Inc	Telecommunications	Cable and Wireless plc	Telecommunications	133	Sold to SoftBank
March 2005	Carrefour Japan	Retail	Carrefour	Retail	96	Sold to Aeon
May 2005	Colin Medical Technology	Healthcare	The Carlyle Group	Investment	-	Sold to Omron
June 2005	Japan Telecom	Telecommunications	Ripplewood Holdings LLC (RHJ Holdings)	Investment	133	Sold to SoftBank
August 2005	CapGemini Japan	Business consulting services	CapGemini	Business consulting services	35	Sold to NTT Data
October 2005	Fuji Heavy Industries Ltd.,	Automobiles	General Motors Corporation	Automobiles	654	Sold 8.7% of outstanding shares to Toyota Motor. Acquired 8.0% as treasury stock.
October 2005	Tokyo-Star Bank	Banks	Lone Star (U.S.)	Investment	718	Listing on Tokyo Stock Exchange
November 2005	First Credit Corp	Mortgage banking and loans	Lone Star (U.S.)	Investment	1,135	Sold to Sumitomo Trust & Banking for US$1,135,420,000.
December 2005	Taiyo-Ryokka Sunpark Sapporo Golf Club Golf Seiyo	Golf courses	Lone Star (U.S.)	Investment	380	Pacific Gold Management, which operates the golf courses listed on the left, is listed on the Tokyo Stock Exchange
February 2006	Minit Japan Ltd.,	Consumer products and services	UBS	Security brokerage, dealing and floatations	123	Sold to a group of investors that includes the management team
February 2006	Shin-Urayasu Oriental Holel Namba Oriental Hotel Kobe Meriken Park Oriental Hotel Hakata Nakasu Washington Hotel Plaza Nara Washington Hotel Plaza Hotel Nikko Alivila	Hotels	Goldman Sachs Group	Security brokerage, dealing and floatations	400	Japan Hotel and Resort, a REIT with six hotels, including three sold by the Daiei group as part of its restructuring, via group member TK Development, was listed on the Tokyo Stock Exchange.
March 2006	Suzuki Motor Corporation	Automobiles	General Motors Corporation	Automobiles	1,956	Suzuki acquired 17.4% of outstanding shares as treasury stock.
April 2006	Vodafone Japan	Telecommunications	Vodafone	Telecommunications	17,531	Sold to BB Mobile (a SofBank subsidiary).
April 2006	Isuzu Motors	Automobiles	General Motors Corporation	Automobiles	268	Mitsubishi Corporation and Ito Chu each acquired 3.26% of outstanding shares.

Sources: Thomson Financial; press releases; newspapers.

C. Counterfeiting

Trade in counterfeit products remained rampant in global markets. Going forward, it will be necessary to prevent the manufacture of counterfeits at the source, including China and other countries, as well as to prevent their export. Europe, North America and Japan must step up border enforcement procedures, as well as enhance the protection of intellectual property through treaties and other cooperation.

1) Counterfeit and Pirated Products Crossing Borders

Customs authorities in Japan, the United States and Europe reported growing volumes of counterfeit products. In Japan, for example, discoveries of contraband by customs authorities rose 47.3% to 13,500 cases. Similar trends were seen in the United States and Europe. The OECD estimated that sales of counterfeit products accounted for 5% to 7% of total world trade. If this estimate is correct, the value of counterfeit trade was a staggering $600 billion in 2005.

China was the top source of contraband entering Japan, the United States and Europe. Chinese customs authorities uncovered exports of contraband in just 1,200 cases, a strong indication that Chinese customs operations must be beefed up.

2) International Cooperation to Strengthen Borders

Japan steadily expanded the range of potential counterfeit products it subjects to border enforcement procedures, both for imports and exports. In the EU, meanwhile, the need arose for penalties and other regulations to be unified across the union’s 25 member countries. China took steps to revise its laws in accordance with the TRIPS Agreement, but enforcement was blatantly inadequate.

Although companies must take resolute steps when their rights are violated, individual companies find it difficult to solve such problems by themselves, which is why a

national-level response is imperative. In Japan, joint efforts have included the creation of the International Intellectual Property Protection Forum (IIPPF), which has set up Intellectual Property Research Groups (IPGs) in Beijing, Shanghai and Guangzhou to exchange information on anti-counterfeiting measures and propose improvements in regulatory systems to the government of China.

Developing countries with insufficient oversight functions must work more closely with institutions such as Interpol and the World Customs Organization. The Japanese government has advocated strengthening the TRIPS Agreement, offering proposals to reduce the spread of counterfeit and pirated goods, but the key will be to ensure that multilateral treaties include the countries where counterfeit products are made.

Fig. 23 Counterfeit products seized by customs

(number of cases)

	2000	2001	2002	2003	2004	2005
Japan	1,589	2,812	6,978	7,412	9,143	13,467
U.S.A.	3,244	3,586	5,793	6,500	7,255	8,022
EU	6,253	5,056	7,557	10,709	22,311	n.a.
China	295	330	573	756	1,051	1,210

Note: Data for the U.S.A. are on a fiscal year basis. For Japan, the U.S.A. and the EU, figures are cases of imports seized; for China, most were exports.
Sources: National customs statistics.

D. WTO and Free Trade Agreements

1) New WTO Round Gridlocked

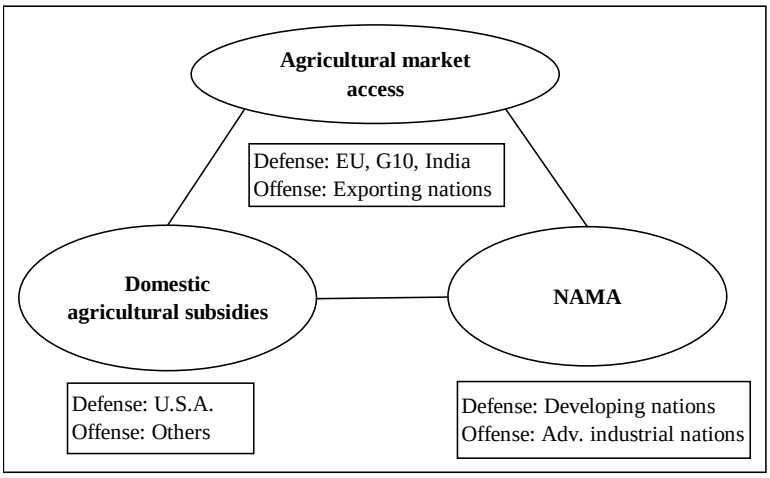
The Doha Round held in Qatar in late 2001 had hoped to negotiate a new world trade agreement. Some major member states, however, remained opposed to clauses concerning basic modalities for non-agriculture market access (NAMA) that would eliminate tariffs on agricultural and non-agricultural products. The biggest problems were:

- negotiations on market access for agricultural products (including eliminating tariffs and product classifications), with the EU and the G10 (a group of agricultural product importers including Japan) the main obstacle,
- domestic agricultural subsidies, with the U.S.A. the main obstacle, and
- NAMA, opposed by developing countries such as India and Brazil.

The result has been a three-way impasse.

An unofficial cabinet-level meeting on July 23, 2006 was unable to break this impasse. WTO Director General Pascal Lamy expressed the opinion that an agreement is not pending, and that preparations for a new round remain frozen. Moreover, the likelihood of further delays is increasing as the expiration of the U.S. Trade Promotion Authority (TPA) in July 2007 approaches.

Fig. 24 Gridlock over agrimarket access, subsidies and NAMA



Source: Ministry of Economy, Trade and Industry.

2) China's Compliance with WTO

Since joining the WTO in 2001, China has made progress in reducing its customs duties from 13.6% at the time of joining to 9.9% in 2006, and in the creation of a legal framework for trading rights, investment and services. However, according to Japanese firms doing business in China, there have been many cases in which the new legal frameworks have not been implemented thoroughly, or even applied:

Transparency: When permissions are requested, government replies are based on undisclosed regulations.

Inconsistencies between national and local governments: Applications made to local governments to do business are rejected, even when legal procedures are followed under the guidance of lawyers, because the local governments claim to be awaiting word from the central government.

Arbitrary interpretation of laws: Products for which there are no domestic suppliers are subject to anti-dumping investigations.

There have also been cases in which restrictive measures were introduced as a matter of national government policy. For example, under the Law Concerning Management of Imports of Specialized Automotive Parts for Finished Automobiles, announced in 2005, if the total value of imported parts reaches 60% of the price of the finished vehicle, a 25% duty for a finished automobile is applied instead of a 10% customs duty on the imported parts. As a de facto demand for local content, this law may be in violation of the Trade Related Investment Measures (TRIM) agreement.

Joint public-private missions have sought improvements in these areas, with both the government of Japan and Japanese firms thoroughly familiar with WTO agreements drawing attention to the issue of China's compliance. When confronting shared problems, Japan must cooperate with Europe and the United States in forcefully presenting its case to China.

Fig. 25 Laws China introduced or revised after joining WTO

	Commitments	New/revised laws	Status
Comprehensive	Trade rights	Revision of the Foreign Trade Law	In compliance
	Anti-dumping and countervailing duties	Anti-dumping and countervailing duty regulations, and detailed rules of enforcement	In compliance
	Safeguards	Safeguard mechanism regulations and detailed rules for enforcement	In compliance
	Trade-related investment	Revision of the Foreign Corporation Law, Law on Chinese/Foreign Joint Ventures and Law on Chinese/Foreign Invested Businesses Law on Foreign Investment in Wholesaling and Retailing and detailed rules for enforcement	In compliance
	Intellectual property	Patent Law, Trademark Law, Copyright Law, Law Countering Unfair Competition, Integrated Circuit Design Protection Regulations, Computer Software Protection Regulation, and other laws covering procedures	In compliance
	Government procurement	Government Procurement Law of the People's Republic of China	In compliance
Industry-specific	Automobiles	Revision of Automotive Industry Development Policies and introduction of Auto Import Approval System and Automobile Brand Marketing Law	In compliance
	Pharmaceuticals	Imported Pharmaceuticals Law and others	In compliance
	Retailing	Law on Foreign Investment in Wholesaling and Retailing and detailed rules of enforcement	In compliance
	Logistics	Rules for Foreign Investment in Land Transport and Law on Foreign Investment in International Shipping Agencies	In compliance
	Telecommunications	Revision of Rules for Foreign Investment in Telecommunications Companies, Classification of Telecommunications Businesses, and Rules for Internet Information Services	Not yet
	Finance	Revision of the People's Bank of China Law and People's Republic of China Commercial Banking Law, China Banking Regulatory Law, and others.	In compliance
	Construction	Rules for Foreign Investment in Construction Companies	In compliance

Note: "In compliance" means China has introduced adequate legislation to meet this commitment; "Not yet" means some rules for enforcement have yet to be put in place.

Source: METI, *2006 Report on Unfair Trade Policies; and* Beijing Chamber of Commerce, *China's Economy after WTO Accession*.

3) Japan and Developing Asia: FTA and EPA Trends

According to JETRO statistics compiled from WTO reports, 148 free trade agreements (FTAs) had been concluded worldwide as of June 15, 2006. In East Asia, many FTAs are now being negotiated, a trend suggesting that many new agreements will be introduced in the foreseeable future:

Agreements in effect, or finalized

China: Agreement on Trade in Goods in effect since July 2005. FTA with Chile scheduled to go into effect in mid-2006.

Republic of Korea: Signed FTA with European Free Trade Association (EFTA), and Framework Agreement and Agreement on Trade in Goods with ASEAN, both in December 2005. FTA with Singapore in effect since March 2006.

Singapore: FTAs with Jordan and India in effect, both since August 2005. Trans-Pacific FTA with New Zealand, Chile and Brunei, signed and awaiting ratification. FTA with Panama signed in March 2006. Negotiations with Qatar completed.

Thailand: FTA with New Zealand in effect since July 2005.

Agreements under negotiation

China: Australia, New Zealand and Gulf Cooperation Council.

ROK: Japan, Canada, India, the U.S.A. and EU (preliminary talks).

Thailand: India (advanced stage), and U.S.A. and EFTA.

Singapore: Kuwait and Pakistan.
ASEAN: Japan, India, Australia, New Zealand, the U.S.A. (Trade and Investment Framework Agreement) and EU (research committee).
Malaysia: U.S.A.

The EPA between Japan and Malaysia effective from July 13, 2006 represented Japan's third EPA, following agreements with Singapore and Mexico. After first concentrating on East Asia, Japan has expanded its scope to include Chile, the Gulf Cooperation Council, India, Australia and Switzerland. The main objectives include expanded business opportunities and ensuring stable supplies of resources. Agreements with India and Australia are, like agreements with ASEAN, the ROK and other East Asian partners, seen as steps toward concluding EPAs throughout Asia. Countries and regions with which Japan has concluded, is negotiating or is considering an EPA account for 32% of the country's total trade.

Cooperative bodies taking shape throughout East Asia are expected to further the movement toward EPAs in the region. At the ASEAN Plus Three Summit in December 2005, the participants reaffirmed their conviction that the ASEAN Plus Three process would be the main vehicle for achieving an East Asian community, and they announced their intention to set forth the future direction of cooperation and East Asia community building. They also agreed to speed up implementation of the East Asia Study Group's proposed measures for facilitating FTAs. In addition, during the first East Asia Summit, which took place two days later, representatives from the ASEAN Plus Three nations, joined by counterparts from Australia, New Zealand and India, announced their belief that the summit, chaired annually by ASEAN participants, will have a key role to play in the years to come.

Fig. 26 FTAs and EPAs in Asia (as of August 1, 2006)

Country/region	In Effect	Signed	Basic Agreement	Under Negotiation
Japan	Singapore, Mexico, Malaysia		Philippines, Thailand	ROK (interrupted), ASEAN, Indonesia, Chile, GCC, Brunei
China	Hong Kong, Macao, ASEAN	Chile		New Zealand, Australia, GCC
Rep. of Korea	Chile, Singapore, ASEAN	EFTA		Japan (interrupted), Canada, India, U.S.A.
Hong Kong	China			New Zealand
Macao	China			
Taiwan	Panama, Guatemala	Nicaragua		
ASEAN	AFTA, China, Korea			Japan, India, Australia, New Zealand
Singapore	New Zealand, Japan, EFTA, Australia, U.S., Jordan, India, Korea	Trans-Pacific (New Zealand, Chile, Brunei), Panama	Qatar	Canada (interrupted), Mexico (interrupted, Kuwait, Pakistan
Thailand	Australia, New Zealand	Bahrain (framework), Peru (framework), India (framework), BIMST-EC (framework), (Bangladesh, India, Myanmar, Sri Lanka, Nepal, Bhutan)	Japan	U.S.A., EFTA
Malaysia	Japan			New Zealand, Australia, Pakistan, U.S.A.
Indonesia				Japan
Philippines			Japan	
Brunei		Trans-Pacific (Singapore, New Zealand, Chile, Brunei)		Japan
India	Sri Lanka, Thailand, Singapore, SAFTA	BIMST-EC		
Australia	U.S.A.			Malaysia, China, ASEAN
New Zealand	Australia			Hong Kong, Malaysia, China, ASEAN

Sources: JETRO, *Overview of Major Japanese and Worldwide FTAs*; press reports; and other materials.

2. Opportunities in Emerging Economies

A. Growth of Emerging Economies

Throughout the 1990s, industrialized nations powered global sales of consumer products such as automobiles and mobile phones. Since 2000, however, demand has also been growing in emerging economies such as Brazil, India and Russia, as well as East Asia. For example, global sales of four-wheeled vehicles rose by about seven million between 1999 and 2004, with China accounting for half and India more than 7%. Mexico, Thailand and other emerging economies have also contributed to rising sales of automobiles. Going forward, emerging economies such as Turkey, Thailand, Mexico and Indonesia, as well as the BRICs, are expected to fuel further demand for automobiles and mobile phones.

Among the emerging economies, India had the lowest rates of penetration for major consumer goods such as automobiles and televisions; per 100 persons, the rates included TVs–8.4, PCs–1.2 and mobile phones–4.4. Equivalent figures for China were 38.2, 4.1 and 25.8, respectively.

Fig. 27 Contributions to global market expansion

(%)

Ranking	4-wheeled vehicles		2-wheeled vehicles		Electronics		Mobile phones		Personal computers	
	unit sales, 1999-2004		unit sales, 1999-2004		demand (nominal $), 2002-2005		subscribers, 1999-2004		1999-2004 total	
1	China	45.9	Indonesia	34.7	China	24.1	China	23.1	U.S.A.	21.6
2	Iran	7.9	India	26.7	U.S.A.	12.3	U.S.A.	7.6	China	9.8
3	India	7.4	Thailand	15.7	Japan	11.7	Russia	5.8	Japan	8.6
4	UK	6.7	Vietnam	11.1	Germany	7.4	Brazil	4.0	UK	4.7
5	Mexico	5.9	U.S.A.	8.9	ROK	3.2	Germany	3.8	ROK	4.6
6	Thailand	5.8	China	8.8	France	3.2	India	3.6	Germany	4.1
7	Russia	5.6	Brazil	5.5	UK	3.1	Japan	2.7	France	3.6
8	Indonesia	5.5	Philippines	2.1	Italy	2.7	UK	2.7	Russia	3.5
9	Turkey	5.0	Pakistan	1.5	Taiwan	2.5	Italy	2.6	Brazil	3.5
10	Brazil	4.6	Mexico	1.1	Australia	1.9	Mexico	2.4	Canada	3.0
11	Malaysia	2.8	Canada	0.3	India	1.9	Philippines	2.4	India	2.5
12	Australia	2.4	Colombia	0.3	Spain	1.8	Indonesia	2.2	Taiwan	2.0
13	South Africa	2.2	Bangladesh	0.3	Brazil	1.8	Turkey	2.1	Saudi Arabia	1.9
14	Ukraine	2.2	Peru	0.2	Russia	1.7	Thailand	2.0	Italy	1.9
15	Spain	2.0	Sri Lanka	0.2	Singapore	1.7	Spain	1.9	Mexico	1.8

Notes: 1. Figures indicate share of growth.
2. 2005 figures for electronics are estimates by Reed Electronics Research.
Sources: Euromonitor; FOURIN, *Global Automotive Manufacturers Yearbook, 2004* and *2005;* Honda; Reed Electronics Research; and ITU.

Fig. 28 Spread of products and services in major emerging markets

	Autos	Televisions	PCs	Mobile phones	Internet Access
	Persons per auto	TVs per 100 persons	PCs per 100 persons	Subscribers per 100 persons	Users per 100 persons
	Persons	Units	Units	Persons	Persons
	2003	2003	2004	2004	2004
China	54.7	38.2	4.1	25.8	7.2
India	99.6	8.4	1.2	4.4	3.2
Russia	5.0	34.6	13.2	51.6	11.1
Indonesia	35.1	15.2	1.4	13.5	6.5
South Korea	3.3	45.9	54.5	76.1	65.7
Brazil	8.6	36.8	10.7	36.3	12.2
Iran	16.3	17.4	10.5	6.2	7.9
Thailand	n.a.	29.0	6.0	44.2	11.3
Turkey	11.1	54.2	5.1	48.0	14.1
Mexico	n.a.	28.3	10.7	36.6	13.4
Taiwan	3.7	44.1	52.8	100.3	53.8
South Africa	7.4	19.7	8.3	43.1	7.9
Pakistan	n.a.	8.2	-	3.3	1.3
Ukraine	7.4	36.0	2.8	28.5	7.8
Philippines	n.a.	19.2	4.5	39.9	5.3
Vietnam	189.7	20.9	1.3	6.0	7.1
Argentina	6.6	32.8	8.0	35.4	16.1
Bangladesh	n.a.	7.3	1.2	2.0	0.2
Saudi Arabia	3.4	28.2	34.0	36.8	6.4
Poland	2.9	22.9	19.1	59.9	23.4
Malaysia	3.8	21.8	19.2	57.1	38.6
Reference: U.S.A.	1.3	95.0	76.2	62.1	63.0
Japan	1.7	84.3	54.2	71.6	50.2

Sources: ITU; ITU Association of Japan; FOURIN, and *Global Automotive Manufacturers Yearbook, 2005* .

B. Western and ROK Firms in India

India, the world's second largest nation in terms of population, has been attracting increasing interest from a long-term perspective. As income levels rise in step with economic growth, the middle class and its purchasing power will expand accordingly, particularly in the cities. Business opportunities in India are also on the rise thanks to deregulation. Marketing and distribution infrastructure, however, remain underdeveloped, and the many linguistic and cultural differences between regions present unique marketing challenges.

How large is the middle class? According to India's National Council for Applied Economic Research, as of 2001 households with annual incomes of $3,775 or more, the highest income bracket, accounted for 14.1 million, or 7.3% of India's 193.6 million households in 2001.

Several foreign companies that have entered the Indian market have overcome challenges by using key strategies:

- Eli Lilly utilizes the sales network of a partner company.
- Unilever has used saleswomen to increase sales in less urbanized regions.
- LG Electronics advertises at sporting events and offers products well suited to local needs.

Fig. 29 Indian market entry: Western and ROK companies

Company	Industry	Entry	Overview
Eli Lilly (U.S.A.)	Pharmaceuticals	1993	• Established a joint venture named Eli Lilly Ranbaxy, emphasizing the firm's foreign connections to capitalize on the local image that imported medications offer high quality. • Used Ranbaxy route to full extent, securing all necessary licenses from government to build a strong sales network. • Secured superior personnel, gave sales staff swift promotions and adapted U.S. parent's trainng program to local conditions. • Focused on niche treatments and introduced low-risk products. Manufactured medications locally, but did not follow mass-production, low-price strategy, instead using international prices as criterion. Did not introduce products vulnerable to patent violations to the Indian market. • Basically introduced pharmaceuticals in areas other firms would have difficulty entering. Divided product line into two groups: pharmaceuticals for which patents had expired but Eli Lilly had added unique value, and patent-protected pharmaceuticals in areas difficult to enter for other firms. • Sales calls to physicians emphasized the provision of added-value information about the drugs.
Unilever (UK)	Toiletries	1931	• Launched the Project Shanty marketing program in 2000, under which women are appointed "entrepreneurs" to sell in designated territories. Remuneration can be paid to individuals, or groups, and low-interest financing is provided to help sales people start their own businesses. • Products are made available in small sizes to make them affordable for low-income customers, yet sales margins are higher than for large sizes. • Trains female specialists in health and hygiene as a social contribution, and to improve its reputation.
Lucent Technologies (U.S.A.)	Communi-cations equipment	Latter half of 1980s (as AT&T office)	• In 1992, AT&T established a joint venture with Tata Telecom, a giant industrial group, and in 1994 it tied up with the Birla Group and secured permission to offer mobile phone services in western India. Lucent Technologies, after being spun off from AT&T in 1998, acquired in 1999 a majority share of Tata Lucent Technologies and renamed it Lucent Technologies Hindustan. Four of the five private-sector telecom operators are now customersof Lucent's switching and transmission products. Lucent has a 35% share of the cable market.
Hyundai Motor (ROK)	Automobiles		• Under decisive, top-down decision making it has invested more in production capacity than rivals, and now reaps the benefits of mass production. • Working closely with the Indian government, it won approval to set up a wholly owned subsidiary and, by bringing its affiliated autoparts makers along with it into the Indian market, can now battle local automaker Tata for second place in market share.
LG Electronics (ROK)	White goods and consumer electronics	Latter half of 1990s	• Has improved its name recognition by sponsoring cricket matches and other events. • Has built up a sales network throughout India. • Carefully picks products that suit local needs. • Assigns corporate vice presidents to serve as presidents of the Indian operation, ensuring speedy decisions and demonstrating local commitment.

Source: JETRO.

C. ROK Firms in China and Brazil

Companies from the Republic of Korea have been boosting investments in China at a dazzling rate, while also increasing substantially their investments in other developing countries. A distinctive feature of their common strategy has been to make bold investments at the start and get their businesses up and running in a short time, thanks to top-down decision making.

ROK companies that sell consumer goods have successfully targeted both the high-end and high-volume market segments. They also differentiate themselves by introducing products with specifications suited to local needs, and emphasize their local commitment through advertising and other image-enhancement efforts.

In China, Hyundai Motor outstripped Guangzhou Honda and other Japanese-affiliated manufacturers to achieve the fourth largest share of the automobile market in 2005. In India, its presence has grown so significantly that it is now competing with local carmaker Tata Motors for the second largest market share. Another ROK firm, LG Electronics, is an especially noteworthy foreign firm in China's white goods market because it is vying for the top market share. Moreover, rapid decision-making has helped it gain top shares of 20-30% each in India's air conditioner, refrigerator and washing machine markets.

Fig. 30 ROK companies entering the Chinese market

Company	Industry	Entry	Overview
Hyundai Motor	Automobiles	2002	• Hyundai Kia Automotive Group has two passenger car joint ventures in China, Beijing Hyundai Motor Company and Dongfeng Yueda Kia Automobile Company. • Beijing Hyundai is a 50:50 joint venture by Hyundai Motor and Dongfeng Yueda Kia Automobile Company. Sales in 2005 came to 234,000 vehicles, or 7.5% of the market, showing fast growth. It has the fourth largest market share, more than Japanese automakers such as Guangzhou Honda. • Beijing Hyundai succeeded in becoming one of the top manufacturers in a short period of time because it targeted the demand for taxis in Beijing and offered price-sensitive customers prices 15-20% below those of competitors.
LG Electronics	White goods and consumer electronics	1993	• LG Electronics has introduced products that suit Chinese consumer preferences, and are localizing human resources, production, marketing and R&D. • It has enhanced its image through social contributions, such as donating hygienic supplies and equipment to major hospitals. • It is competiting for top market share in white goods (washing machines, refrigerators, microwave ovens, etc.), making it unique among foreign-affiliated companies.

Source: JETRO.

Fig. 31 ROK companies entering the Brazilian market

Company	Industry	Entry		Overview
LG Electronics and Samsung Electronics	Consumer electronics	1996 & 1995		• LG has production centers in the Manaus Free Trade Zone (ZFM) and in Taubate, Sao Paulo. It produces a broad range of products, including TVs (CRT, LCD, plasma and projection), plasma monitors, DVD players, air conditioners, audio equipment, and mobile phones. • Samsung began producing TVs in the ZFM and has expanded to products such as mobile phones, LCD monitors, and hard disk drives. • Both market through retail chains funded by local capital and targeting middle- to lower-income customers. Payments are usually by installment with zero-interest loans. • Using inexpensive imported components, they have succeeded in keeping their costs below those of Japanese-affiliated competitors. • In 2005, LG's market share in LCD and plasma TVs equalled that of Philips. • Both LG and Samsung advertise aggressively via magazines, billboards and closed-circuit TV in commercial facilities, airports and other places. • LG installed 200 large-screen plasma TVs in six airports in April 2005. • Both sponsor soccer teams: Samsung the Corinthians and LG the FC Sao Paolo.

Source: JETRO.

D. Chinese Firms in Emerging Economies

Chinese firms are moving into emerging economies, particularly those of India, Russia and the ASEAN countries. Their fields include home appliances, motorcycles, telecommunications, personal computers and bicycles. Huawei increased export sales over 40-fold between 1999 and 2004, and its ratio of overseas to total sales rose from more than 40% in 2004 to about 62% in the first half of 2005.

Chinese firms are eager to enter emerging economies because their home market is maturing and competition is intensifying, cutting into profits. Chinese companies also view many emerging economies as being quite similar to China. Moreover, while these companies lack international name recognition, they are competitive in price, which tends to steer them toward developing countries. They generally focus on India and Russia in their planning because both countries lack strong local manufacturers.

A typical approach is to enter a market with low-tech products, then gain market share through low prices and superior after-sales service. They also emphasize brand enhancement, strategic selection of products with short-term return potential and the development of specific countries as potential production bases for exporting to third countries in the future.

Fig. 32 Chinese production and sales in emerging markets

		India	Russia	ASEAN	Brazil
TCL	Production	• Set up a subsidiary in March 2004. Has 7 plants and 100 after-sales service centers and network of nearly 2,700 salespersons. • Acquired the Tomson R&D center, with over 40 engineers and other technical staff.	• Set up a subsidiary and 3 production plants.	• Plants in Vietnam (600,000 color TVs annually), Indonesia, Philippines and Thailand. • Acquired Tomson's R&D center in Singapore with over 200 engineers and other technicians.	
	Sales	Color TV sales in 2005 topped 600,000, or 6% of market.	Color TV sales topped 400,000 in 2004, and was estimated at 800,000 in 2005, or 10% of market.	• 16% share of color TV market in Vietnam in 2004. • Sold 80,000 air conditioners in Indonesia in 2004, or 4% market share, and nearly 120,000 units in 2005.	
Huawei	Production	• Set up Huawei Telecom. • Founded Huawei Technologies India, its largest R&D center outside China, with over 1,000 employees. Cumulative investment of US$100 million.	• Founded Beto-Huawei, a joint venture with a Russian firm. • Set up an R&D center.	• Subsidiaries, branches or representative offices in Singapore, Malaysia, Thailand, Cambodia, Vietnam, the Philippines and Indonesia, mainly for marketing. • Asia Pacific HQ in Malaysia.	• Huawei Brazil, joint venture with a Brazilian company. • Has about 800 employees in South America. • Planning a cell phone factory.
	Sales	Supplied US$460 million worth of telecom equipment to BSNL and MTNL, India's state-owned telephone companies.	• Sales topped US$300 million in 2003 in former USSR states, making it Huawei's largest overseas market at that time. • More than 50% share of broadband market.	• 2005 sales estimated at US$600 million. • Expected to exceed 50% share of broadband and next-generation network components market and 30% of mobile products market.	• Expected to double sales from US$100 million in 2004 in just one year. • Second largest share of broadband market.
Lenovo	Production	• Ranks third, with 7% market share. • Business tie-ups with 1,000 companies and 33 ThinkWorld shops to handle Think brand products exclusively. • In the third quarter of 2005, accounted for 14.8% of business desktop PC market and 28.4% of business notebook market.	Since trade between China and Russia in IT and telecommunications areas has is not open, Lenovo has almost no speciality shops in Russia, while IBM has a PC division in Russia.	In first quarter of 2005 had 11% market share, replacing Hewlett Packard as No. 2.	• 4.8% share of market for business desktops and 14.4% for notebooks, ranking 4th in general PCs and 2nd in business PCs (Sept. 2005). • 60% of revenues from well-established customers. Has over 60 sales route tie-ups.
	Sales	• Plans to enter consumer market in 2006, launching sales of Lenovo desktop and notebook PCs. • Plans to begin assembly operations, expanding capacity of former IBM plant from 600,000 to one million PCs annually.	Offering low-priced PCs in effort to gain larger share.	• Starting mobile phone sales in Thailand, targeting 400,000 to 500,000 handsets in 2006, and among top five in share by 2008. • Moving into Vietnam's mobile phone market, aiming to be fourth largest maker by 2006.	• Began retailing Lenovo desktop and notebook PCs in first half of 2006, targeting small and midsized firms. • Targeting 420,000 PCs by 2008, the top share.

Source: Newspaper articles.

Fig. 33 Lifan Group's investments and sales in ASEAN countries

Country	Investments and Sales
Cambodia	Main store, test marketing store and various branches form a growing sales network. Lifan motorcycle sales reached about US$1 million in 2004.
Laos	Lifan motorcycles were imported for the first time in 2000 at a profit of about US$250 per bike. Now has an assembly plant, and is also licensing production to a Laotian firm.
Indonesia	One of the group's big five markets (along with Iran, Nigeria, the Philippines and Vietnam), sales topped US$10 million in 2005.
Vietnam	Biggest market in ASEAN region. More than 30% market share in 2002. Bought local joint venture of former Chongqing Huawei Motorcycle Company in 2003 to found Lifan Vietnam Motorbike Manufacture JVC. Annual production capacity is 600,000 motorcycle engines and 200,000 completed motorcycles.
Myanmar	Alliance of 21 motorcycle companies, led by Lifan Group based in Chongqing, China, formed the first alliance to export to Myanmar. Members agreed to adhere strictly to minimum export prices.

Source: Newspaper articles.

E. Turkish Firms in Russia

One factor behind the success of Turkish firms in export markets is the powerful international trading networks they have built up over the years. This, as well as geopolitical factors, positions them well to enter neighboring countries, many of which are widely regarded as risky and unimportant consumer markets. Moreover, former socialist states in the region have been receptive to the moderate quality of Turkish products. Accordingly, Turkey has been steadily increasing its share of the home appliance market in Europe. Anticipating increasingly fierce competition from Chinese products, they are also accelerating their efforts to establish manufacturing centers in Russia.

In the beverage segment, another category they view as potentially strategic in developing markets, Turkey’s largest brewery has made notable progress in Russia and other CIS countries. It is now the fourth largest beer producer in Russia, which has become its most important market, representing about 40% of total sales. Turkish glass companies, also investing aggressively in Russia, now meet 20% of the market’s demand for glass bottles. Turkish companies also excel in food distribution and retail (supermarkets), and have swiftly established more than 50 stores in Russia, with 34 in Moscow and an increasing number in regional cities.

Construction, however, has been the mainstay of Turkish international expansion. Between 1972 and 2005, Turkish companies received $47.6 billion in contracts for overseas projects. Libya was traditionally their largest customer, followed by Russia, accounting for $9.5 billion, a 20.0% share. Since the 1990s, however, Russia has become Turkey’s largest customer, thanks to the efforts of the Enka Group.

Fig. 34 Turkish companies in Russian market

Company	Industry	Entry	Overview
Vestel (Zorlu Group)	Appliances	2003	Built TV plant in 2003, and invested in refrigerator and washing machine plants in 2004.
Arçelik (Koc Group)	Appliances	2005	Built washing machine and refrigerator plants. Also bought European companies and brand-name companies in Austria and Germany to enter the European market.
Efes Group (Anadolu Group)	Beer	1999	Has five breweries. Between production under license and its own beer production, has 8% market share, or fourth largest. Success factors include its quick identification of consumer shift from hard liquor to beer in former Soviet states, and establishment of licensed-production tie-ups with local breweries.
Şişe-Cam Group	Glass		Turkey's largest glass manufacturer, has invested in Russia's beverage market. Currently supplies about 20% of all glass bottles in Russia, and plans to increase investment 150% over next five years.
Migros Group	Retail		Turkey's largest supermarket, with 720 stores. Working with Turkish construction giant ENKA Group, it has set up 51 stores in Russia, including 32 in Moscow, and is rapidly expanding into other cities.

Source: JETRO.

F. Brazilian and Mexican Firms in Latin America

Brazilian foreign direct investment generally concentrates on 1) leveraging expertise in natural resources and extractive industries, 2) strengthening presence in the Americas and 3) building presence in Asian markets.

Ambev, the giant Brazilian beverage company, for example, has been moving aggressively to purchase other beverage manufacturers in the Americas. In Latin America, Ambev is the largest beverage company, with a 70% market share for beer and a 17% share for carbonated soft drinks.

Brazilian FDI is usually invested by manufacturers already operating in the host region. Greenfield foreign investments are rare, since most domestic Brazilian firms have low recognition and limited experience overseas. Rather, acquisitions have proven a more effective way to enter foreign markets.

Mexican mobile phone giant América Movil was spun off in 2000 from Telefonos de Mexico, Mexico's largest telephone company, and is now moving into other Latin American markets at a breathtaking pace. In the five-year period ending in 2005, it added 80 million new subscribers and expanded operations to encompass 14 countries, including the United States, as well as Latin America. As of March 2006, it had 160 million total subscribers. The firm has been aggressively acquiring other mobile phone carriers in Latin America, spending a combined $16 billion on acquisitions and post-acquisition improvements in infrastructure. The drive to acquire foreign firms resulted in foreign operating revenues ($8.6 billion) exceeding domestic Mexican revenues ($8.4 billion) in 2005.

Fig. 35 Brazilian companies with overseas bases

Company	Industry	Bases (incl. sales) in other countries	Countries	Countries
Petrobras	Petroleum, gas	18	18	Angola, Argentina, Bolivia, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Portugal, U.S.A., United Arab Emirates, Uruguay, Venezuela.
Odebrecht	Construction, engineering	14	14	Angola, Argentina, Bolivia, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Portugal, United Arab Emirates, U.S.A., Uruguay, Venezuela.
Companhia Vale do Rio Doce (CVRD)	Mining	17	16	Angola, Argentina, Australia, Chile, China, France, Gabon, India, Japan, Mongolia, Mozambique, Norway, Peru, South Africa, Switzerland, U.S.A.
Embraer	Aircraft manufacturing	5	5	China, France, Portugal, Singapore, U.S.A.
Gerdau	Iron and steel	14	7	Canada, Chile, Colombia, Spain, U.S.A., Uruguay, Argentina
WEG	Electric motor production	20	19	Argentina, Australia, Belgium, Chile, China, Colombia, France, Germany, India, Italy, Japan, Mexico, Netherlands, Portugal, Spain, Sweden, U.S.A., UK, Venezuela.
Fundição Tupi	Metal casting	8	8	Argentina, China, Germany, Italy, Japan, Mexico, UK, U.S.A.
Marcopolo	Bus manufacturing	23	23	Argentina, Bolivia, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, France, Greece, India, Ireland, Mexico, Panama, Paraguay, Peru, Portugal, Russia, South Africa, UK, United Arab Emirates, Uruguay, Venezuela.
Tigre	Plastics, tubes, piping production	12	11	Algeria, Angola, Argentina, Bolivia, Chile, Ecuador, Guatemala, Nigeria, Paraguay, U.S.A., Venezuela.
Andrade Gutierrez	Construction, engineering	3	3	Peru, Portugal, U.S.A.
Politec	Software	2	2	Japan, U.S.A.
Votorantin	Cement, paper, valve, finance, etc.	12	11	Australia, Bahamas, Belgium, Bolivia, Canada, Germany, Netherlands Peru, Singapore, U.S.A., UK.
Camargo Correa	Construction, engineering	6	6	Argentina, Bolivia, Colombia, Peru, Surinam, Venezuela.
Sadia	Foods (meat products)	10	10	Argentina, Chile, Germany, Japan, Russia, Turkey, UK, United Arab Emirates, Uruguay, Venezuela.

Sources: Tendencia (consulting firm) and company websites.

Fig. 36 América Movil's network (as of December 2005)

(1,000 subscribers)

Country	Industrial group	Entry	Subscribers	Market share	National total
Mexico	Telcel	-	35,914	75.7%	47,462
Guatemala	Telgua	2000	1,912	60.3%	3,168
Ecuador	Conecel	2000	4,100	65.6%	6,246
Brazil	Telecom Americas	2000	18,659	21.6%	86,210
Colombia	Comcel	2002	13,775	63.2%	21,800
Nicaragua	Sercom/Enitel	2002	748	66.8%	1,119
El Salvador	CTE	2003	859	35.6%	2,412
Argentina	CTI	2003	6,627	30.0%	22,100
Honduras	Megatel	2004	427	33.3%	1,282
Uruguay	CTI	2004	168	28.0%	600
Paraguay	CTI	2005	172	9.1%	1,887
Chile	Smartcom	2005	1,884	17.8%	10,570
Peru	Claro	2005	1,950	34.9%	5,583
U.S.A.	Tracfone	2000	6,135	3.0%	201,650
Latin America and Caribbean		-	87,195	36.2%	240,544
Americas, total		-	93,330	20.3%	458,794

Sources: América Movil's annual reports and ITU.

G. Japanese Firms Entering Emerging Economies

Japanese corporations have generally been more cautious than Western or ROK firms in entering emerging economies. But some companies have been remarkably proactive, and an examination of their strategies is instructive:

Low-cost products based on market research
Sharp, which has the top market shares in the Philippines for compact televisions and single-tub washing machines, saw an opportunity under the ASEAN Free Trade Area (AFTA) agreement to begin incorporating lower-cost parts. This enabled it to undercut prices of competing products made in the ROK. It is now considering adapting this strategy for markets in other developing countries.

Small-quantity product sizes are easier for consumers to purchase
Hisamitsu Pharmaceutical in Brazil and Ajinomoto in Nigeria have kept prices low by selling products in smaller sizes, which has led to increased sales.

Door-to-door sales
Yakult, a fermented lactic beverage manufacturer, has increased sales in emerging economies through a home delivery system using saleswomen.

Regional marketing through traditional distribution routes
Acecook, an instant noodle manufacturer, has garnered a 60% share of the market in Vietnam. It has assigned monitors to each province to assess sales and ensure that products are not sold after their best-buy dates, thus maintaining product quality and strengthening brand image.

Fig. 37 Japanese companies in emerging markets

Firm (country)	Field	Entry	Overview
Hisamitsu Pharmaceutical (Brazil)	Pharmaceuticals	1965	• Because Brazil is so vast, Hisamatsu secures sales channels by partnering with major distributors. • The company's Salonpas brand is well established. Since 2001, the company has sponsored the Salonpas Cup international volleyball tournament, which has helped to raise awareness and understanding of medicinal plasters and strengthen ties with major drugstore chains in Sao Paolo. • TV is also used to educate Brazilian consumers about medicinal plasters. In a tie-up with a nationwide variety show, a famous personality serving as master of ceremonies uses the product during the show.
Sharp (Philippines)	Home appliances		• Partners with mass retailers of home appliances. • Headquarters and local sales departments work to develop high-quality products that suit local markets. Responds swiftly and flexibly to market trends, and provides thorough after-sales service. • Works to increase local content ratio and keep prices down. • Almost all local employees, including factory workers, speak English, which facilitates communication. • Upgrading Sharp brand image by introducing LCD televisions and fully automatic washing machines.
Yakult (various)	Beverages	1964-2006	• 20 overseas offices, and sales of Yakult and other fermented lactic acid beverages in 24 countries. • Moved into Taiwan, Brazil and other markets in 1960s, then has focused mainly on emerging markets (ROK, Philippines and Singapore in '70s; Mexico in '80s and Indonesia and Argentina in '90s). Entered Europe and other advanced industrialized countries only from '90s. • Sales in emerging markets accounted for about 16% of total sales in 2005. Top-selling Japanese beverage overseas (unit sales). • Unique home delivery system using female sales staff called the Yakult Ladies.
Kumon (various)	Education	1970s	• Flexible membership fees and other measures used to provide services to as wide a segment of a developing county population as possible, not just the high-income segment. • Repeated interviews required before hiring to find people who believe in the Kumon system. Trains instructors carefully and provides opportunities for additional learning, in part to strengthen shared values. • Emphasizes educational fundamentals of reading, writing, arithmetic, rather than Japanese academic curricula. Programs are readily accepted worldwide.
Mandom (Indonesia)	Cosmetics	1969	• Extensive range of hair and scalp products, plus fragrances and makeup. • Sales in Indonesia rose 113% to 904.7 million rupiahs in 2005. Setting income records year after year. • Stresses consumer-driven products priced affordably, then allocates necessary expenses. • 20% of production is for export to over 100 countries. • Product development is based on surveys of Indonesian consumers. • Products are sold in small quantities and containers to keep prices down. • Uses mass media with impact for promotions. • Uses advertising and sales promotions to rollout important new products.

Source: JETRO.

3. Japan's Deepening Business Ties with East Asia

A. East Asian Free Trade Zone

Discussion of an East Asian economic community began in earnest at the East Asian Summit in December 2005. By about 2015, it is anticipated that a framework will have been concluded to encompass the five ASEAN Plus One economic agreements formed with Japan, China, the Republic of Korea, India, Australia and New Zealand.

The nine East Asian economies (ASEAN5, China, Hong Kong, ROK and Taiwan) accounted for a 9.8% share of world GDP (nominal GDP basis), or 22.3% when recalculated in terms of purchasing power parity. Japan remained the largest economy in the region defined as the above nine economies plus Japan and India, accounting for 47.0% of GDP. China accounted for 23.3% and India 7.9%. Regional demand comprised 52.9% personal consumption and 28.2% fixed capital formation. Japan accounted for 50% of personal consumption and almost 40% of fixed capital formation, forming a foundation for the rest of the regional economy.

GDP growth largely consisted of personal consumption (39.6%), capital investment (36.6%) and exports (18.6%), the latter two being relatively large. China contributed significantly to export and capital investment growth, but only modestly to personal consumption growth. Japan, India and the ASEAN5 made relatively strong contributions to personal consumption, while East Asian NIEs' accounted for large shares of exports and capital investment.

B. Increasing Ties with China, India and Beyond

1) Overall Developments

The ratio of intraregional trade (imports) by Japan, China, the Republic of Korea, Taiwan, Hong Kong and the ASEAN5 rose from 52.5% in 1999 to 56.5% in 2005. China's share rose from 15.6% to 28.2%.

Growth in Chinese foreign trade has been accompanied by a shift in the regions contributing most to exports. Southern China (Fujian, Hunan, Guangdong and Hainan provinces) had been the leading region up to 2005, but then was overtaken by eastern China (Shandong, Zhejiang and Jiangsu provinces). Many Chinese regions export as much as major countries. Eastern China exported more than the ROK, while southern China's exports were on a par with Singapore's. Northern China (Hebei, Henan and Shanxi provinces and the Inner Mongolia Autonomous Region) exported more than Thailand. A division of labor continues to develop between Japan, the ROK and Taiwan. The ROK is building the Yellow Sea Economic Zone with northern China, just across the Yellow Sea. Taiwan is building the Straits Zone with southern and eastern China, just across the Straits of Taiwan.

2) Japanese Investment in China

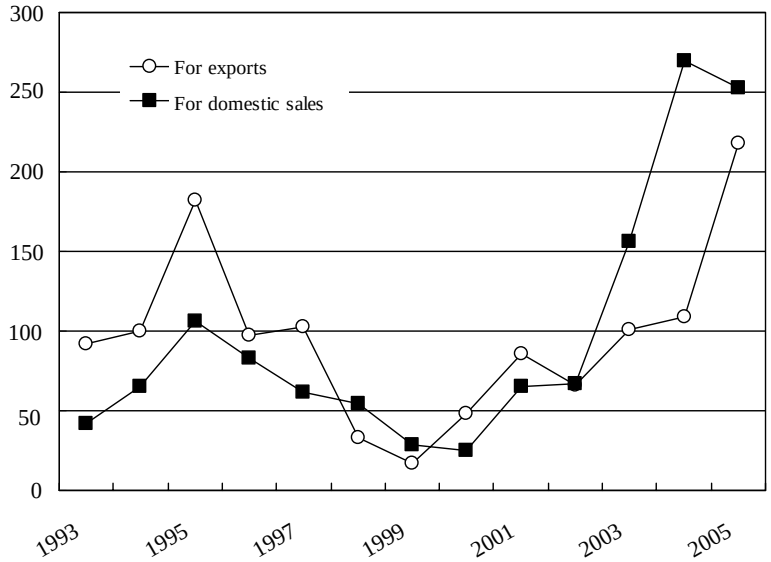
Japanese investment in China, according to Japanese statistics, totaled ¥502.4 billion invested in manufacturing operations from 1990 to 1994. This grew to ¥891.9 billion between 1995 and 1999 and ¥1,101.3 billion between 2000 and 2004. Investment in production for sale within China (such as automobile production) has exceeded production for exports (such as

electronic goods) in recent years.

Bilateral trade rose from $89.2 billion in 2001 to $189.4 billion in 2005, or more than double in four years. China accounted for 17.0% of total Japanese foreign trade in 2005, almost equal to that with the United States (17.9%). As trade has grown, so has the Chinese-Japanese division of labor, with machinery accounting for the largest proportion.

Fig. 38 Japanese direct investment in China

(¥ billion)



Notes: Fiscal years to 2004, calendar thereafter. Export fields include electrical and electronic equipment, machinery (general and precision) and textiles. Domestic sales cover all other types.
Sources: Ministry of Finance, *Outward and Inward Direct Investment*; and Ministry of Finance, *Trade Statistics*.

Fig. 39 Japan's trade with China

(%)

	2000		2005	
Exports	Electrical equipment	27.5	Electrical equipment	25.9
	General machinery	19.5	General machinery	21.2
	Chemicals	13.1	Chemicals	13.0
	Metal & metal products	10.7	Metal & metal products	10.6
	Textiles & textile products	9.7	Precision instruments	5.3
	Transport equipment	3.9	Transport equipment	5.0
	Precision instruments	4.0	Textiles & textile products	4.4
	Non-metal/mineral products	2.0	Non-metal/mineral products	1.0
	Food	0.5	Food	0.4
	Other	9.0	Other	13.2
	Total	100.0	Total	100.0
	2000		2005	
Imports	Textile products	30.3	Machinery & equipment	40.8
	Machinery & equipment	26.1	Textile products	19.5
	Food	10.7	Food	7.3
	Metal & metal products	4.0	Metal & metal products	5.8
	Mineral fuel	3.9	Chemical products	3.9
	Chemical products	3.0	Mineral fuel	3.0
	Raw materials	2.7	Non-metal/mineral products	1.7
	Non-metal/mineral products	2.0	Raw materials	1.6
	Other	17.3	Other	16.6
	Total	100.0	Total	100.0

Source: Ministry of Finance, *Trade Statistics.*

3) India's Growing Trade with East Asia

India has been working on FTA agreements and strengthening economic ties with East Asia, particularly the ASEAN countries since the 1990s, as part of its Look East Strategy.

When China and the ASEAN countries agreed in 2001 to conclude an FTA within the decade, it sparked a trend toward economic alliances and FTA negotiations throughout Asia. India and Thailand created an FTA Early Harvest Scheme, which accelerated tariff reductions on 82 items beginning in September 2004, spurring new exports. Thailand began exporting home electronics (TVs and air conditioners), electronic components (CRTs) and polycarbonates to India, while India began exporting car parts to Thailand.

The share of Indian exports accounted for by the ASEAN states, Japan, China and the ROK rose from 13.3% in 1999 to 20.9% in 2005. Exports to China and the ASEAN states alone rose to 6.6% and 10.3%, respectively. Exports to Japan were conspicuously low at 2.4%. India purchased only 1.3% of East Asia's total exports in 2005, but this has been gradually rising.

C. Major Issues Going Forward

As ties grow deeper within East Asia, several issues must be addressed in the changing environment. Japanese companies have been building up their processing and manufacturing capabilities in East Asia through investment. Revenues from these investments increased 34.5% to $9.6 billion in 2005, the highest ever since data was first gathered in 1996. Japan's nominal gross national income (GNI), which also includes overseas income, grew faster than GDP for the third year running. But as the Japanese economy continues to use economic expansion in other East Asian economies to leverage its own growth, Japanese companies need to consider the following key points:

China's tightening business environment and the attractiveness of ASEAN

China is becoming less attractive as a manufacturing base for exports as wages rise, pressure for the yuan's upward revaluation yuan grows and the "China risk" persists. Building factories in ASEAN countries that are concluding multilateral FTAs is becoming more advantageous.

Value of alliances with East Asian corporations

East Asian corporations have the corporate resources to respond quickly in fast-growing East Asian markets. Alliances with such companies are particularly valuable when doing business in China or India, where corporate resources are limited.

Need to globalize product development

Japanese corporations need to shed their excessive focus on the Japanese market and their overemphasis on acting alone rather than working through business alliances. They must develop competitive products for international markets, particularly the fast-growing East Asian markets. Nokia, for example, having built a development center in China to introduce low-priced products, has not only reclaimed its top market share of the Chinese cell phone market, it is introducing these products in other markets of the world. The time has come to shed insistence on acting alone and to take advantage of technologies, know-how and human resources from around the world.

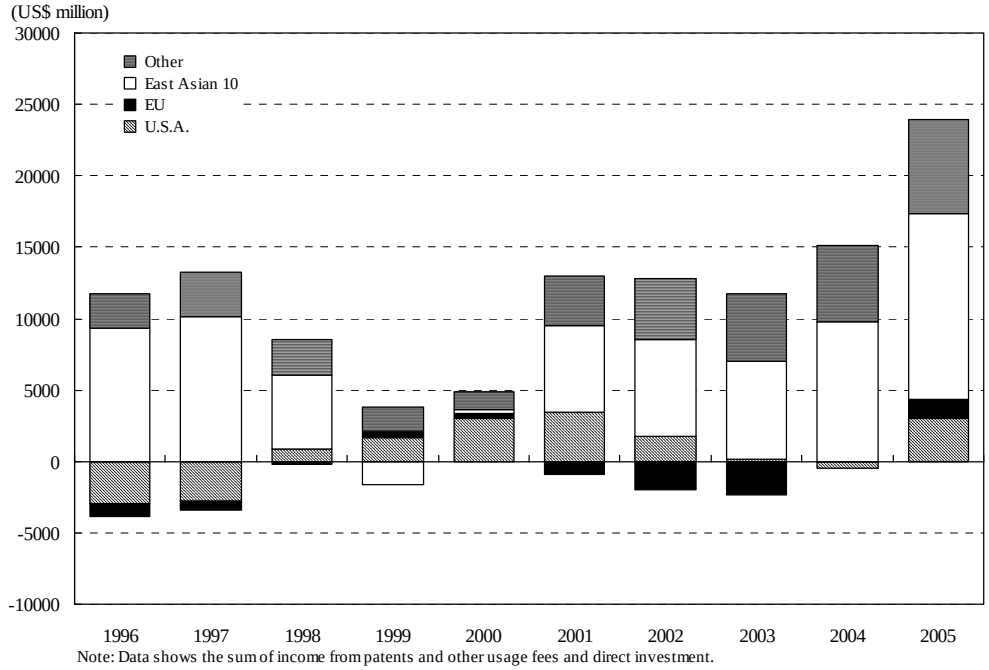
Fig. 40 Japanese exports in 2005

(US$ million, %)

	World		East Asia 9 & India		China		Asian NIEs		ASEAN 4		India	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Total Value	598,215	-	282,968	-	80,340	-	145,467	-	53,622	-	3,539	-
Foods and consumer products	2,664	0.4	1,734	0.6	354	0.4	1,163	0.8	215	0.4	2	0.1
Industrial supplies	125,204	20.9	86,856	30.7	26,889	33.5	43,559	29.9	15,201	28.3	1,207	34.1
Crude materials	6,618	1.1	5,513	1.9	2,695	3.4	2,221	1.5	547	1.0	50	1.4
Mineral fuels	4,570	0.8	2,795	1.0	1,293	1.6	1,214	0.8	197	0.4	91	2.6
Industrial chemicals	52,122	8.7	35,191	12.4	10,324	12.9	19,658	13.5	4,739	8.8	470	13.3
Metals	35,064	5.9	27,018	9.5	7,180	8.9	12,523	8.6	6,958	13.0	357	10.1
Textiles	6,567	1.1	4,758	1.7	2,907	3.6	1,331	0.9	466	0.9	54	1.5
Capital equipment	329,420	55.1	160,995	56.9	44,460	55.3	81,660	56.1	32,794	61.2	2,081	58.8
Non-electric machinery	121,711	20.3	55,695	19.7	17,089	21.3	25,205	17.3	12,294	22.9	1,107	31.3
Electrical equipment	123,173	20.6	73,687	26.0	19,646	24.5	39,745	27.3	13,822	25.8	474	13.4
Transport equipment	55,718	9.3	14,334	5.1	2,835	3.5	6,209	4.3	4,949	9.2	341	9.6
Consumer non-durable goods	3,883	0.6	2,195	0.8	475	0.6	1,476	1.0	230	0.4	14	0.4
Textiles products	747	0.1	477	0.2	180	0.2	268	0.2	27	0.1	2	0.1
Consumer durable goods	108,711	18.2	14,874	5.3	3,797	4.7	8,134	5.6	2,795	5.2	148	4.2
Household equipment	496	0.1	122	0.0	22	0.0	87	0.1	13	0.0	0	0.0
Domestic electric equipment	2,504	0.4	622	0.2	134	0.2	395	0.3	87	0.2	6	0.2
Passenger cars	79,989	13.4	4,223	1.5	1,172	1.5	1,955	1.3	1,045	1.9	51	1.4
Motorcycles and bicycles	7,817	1.3	625	0.2	58	0.1	335	0.2	204	0.4	28	0.8
Toys and musical instruments	10,538	1.8	4,157	1.5	1,077	1.3	2,350	1.6	707	1.3	23	0.6
Other	28,332	4.7	16,315	5.8	4,364	5.4	9,477	6.5	2,388	4.5	86	2.4

Note: Percentages indicate proportion of each item in total exports.
Source: Ministry of Finance, *Trade Statistics*.

Fig. 41 Income earned overseas



Note: Data shows the sum of income from patents and other usage fees and direct investment.
Sources: Ministry of Finance; and Bank of Japan, *Balance of Payments*.

1) China's Tightening Business Environment and the Attractiveness of ASEAN

China began to deregulate its markets after joining the WTO. Despite remaining problems, wholesale/retail, finance/insurance, distribution and other industries have been opened to foreign investment, with geographical limitations removed and regulations on equity ratios eased. As one result, the services sector attracted more inward investment than manufacturing for the first time in Shanghai in 2005. Moreover, throughout China's urban areas, there was a growing shift toward investments aimed at satisfying domestic demand. In a

survey by the Japan Bank for International Cooperation, corporations were asked why they regarded China as a promising target for operations. Those answering the “growth potential of the domestic market” greatly exceeded those who said “as a base for exporting (either to Japan or other countries).”

China’s external economic relations have also changed. Its positive trade balance has raised more calls for the yuan to be revaluated upwardly. As of June 2006, the yuan-dollar exchange rate had risen only 1.4% since the yuan’s last revaluation in July 2005. China’s growing trade surplus with the United States is giving rise to trade friction, and many feel that the risk of doing business with China could rise due to possible retaliatory action by the U.S.A., such as implementation of textile industry safeguards.

Another source of concern is China’s changing policies on foreign capital. It is highly probable that incentives put in place to attract foreign capital will be reversed, increasing the burden on foreign companies operating there. Until now, China has been offering tax rates reduced from 33% to 15% for foreign firms operating in special economic zones, as well as a two-year exemption from tax in the first two years of profitability and reduction of taxation in the third year, and zero duty on equipment imported for in-house use. Such incentives, however, are under review, partly because it likely contravenes the WTO principle of not discriminating between domestic and foreign companies, and partly because of a strong reaction against preferential treatment within China. A uniform tax rate for domestic and foreign firms may be adopted by the National People’s Congress as early as 2007, going into effect in 2008. Chinese news sources report the rate would be about 25%, with new incentives set up by industry and region. According to certified public accountants in China, the two-year tax exemption, third-year reduction is likely to be revised. At any rate, uniform tax rates would entail a de facto tax increase for foreign firms in China. Japanese companies investing in China would also lose the tax credit whereby taxes exempted or reduced in China qualify for Japan’s foreign tax exclusion.

Fig. 42 China's merits as an offshore business base

(%)

	2003	2004	2005
Superior human resources	24.2	19.0	17.6
Low-cost labor	74.9	66.1	62.8
Low-cost materials and parts	34.2	21.4	23.7
Base for supplying assembly plants	28.6	28.6	27.5
Has industrial clusters	14.3	16.1	16.5
Disperses country risk	4.5	2.7	3.1
Base for exporting to Japan	22.4	19.4	18.6
Base for exporting to other countries	21.9	20.8	24.2
Both above reasons	44.3	40.2	42.8
Large market	19.7	23.9	27.0
Growth potential of market	82.3	83.3	80.2
Base for developing local products	7.8	6.7	3.8
Infrastructure in place	9.4	3.3	5.9
Preferential taxation on investments	17.4	17.4	13.2
Stable policies for foreign capital	4.5	4.2	1.3
Stable political and social conditions	4.0	4.2	2.0

Source: Japan Bank for International Cooperation, 16th and 17th *Survey Report on Overseas Business Operations by Japanese Manufacturing Companies*.

a) Rising wages in China

A JETRO comparison of wage levels in East Asia in 2000 and 2005 revealed a rise in

Chinese wage levels to well above levels in the Philippines and Indonesia. In Guangdong Province, the minimum wage was increased in July 2005. In Dongguan, it was increased 30% to about $70 a month, over 60% higher than in 2000.

The minimum wage was also raised in Vietnam, for the first time in about seven years, going into effect on February 1, 2006. In the Hanoi and Ho Chi Minh City areas, the minimum wage surged by about 42% to about $50 a month. This was only about $20 lower than in Dongguan.

What matters to the employer, however, is the actual cost of labor, including benefits. When allowances, social security, overtime and other costs are figured in, the average cost per worker was between $160 and $190 a month in the Dongguan region of southern China, whereas in Vietnam it was in the $90 to $110 range. The difference is $70 to $80 per worker per month, a large gap indeed. If labor costs were the only factor, Vietnam would be significantly more attractive than China, although China outstrips Vietnam in the level of its suppliers and other supporting industries.

b) ASEAN's increasing superiority

A JETRO survey during January–February 2006 found that the investment climate in ASEAN countries was not necessarily inferior to China's. In a survey of Japanese firms in the ASEAN region and India (also having affiliates in China), Thailand and Malaysia scored higher than China on points such as political and social stability and infrastructure level. They also were preferred for the transparency of their investment-related legal systems, implying consistency and predictability in policies and more trust in their governments.

Fig. 43 Investment environments in ASEAN countries and India, compared with China

(China = 0; positive values = superior; negative values = inferior)

	ASEAN	Thailand	Malaysia	Singapore	Indonesia	Philip-pines	Vietnam	India
Political and social stability	0.48	0.91	0.85	0.96	-0.23	-0.17	0.74	0.50
Communicativeness of employees	0.42	0.35	0.53	0.88	-0.07	0.63	0.20	0.72
Investment law transparency	0.39	0.69	0.66	0.93	-0.17	0.10	0.07	0.23
Tax system	0.32	0.50	0.62	0.97	-0.35	0.10	0.07	-0.13
Infrastructure	0.07	0.65	0.67	0.96	-0.60	-0.65	-0.75	-0.78
Ease of managing labor	0.34	0.52	0.21	0.85	-0.04	0.17	0.48	0.00
Research and engineering skills	-0.14	-0.07	-0.10	0.75	-0.66	-0.35	-0.21	0.33
Local suppliers	-0.31	0.28	-0.07	0.22	-0.71	-0.86	-0.85	-0.32
Foreign exchange risks	-0.03	0.13	0.30	0.52	-0.68	-0.46	0.28	-0.13
Customs procedures	0.35	0.42	0.64	0.96	-0.14	0.23	-0.07	-0.41
Intellectual property protection	0.23	0.34	0.39	0.94	-0.12	-0.02	-0.07	0.04
Average	0.19	0.43	0.43	0.81	-0.34	-0.12	-0.01	0.04

Note: Ratios obtained by subtracting "inferior" replies from "superior" replies, then dividing by total replies.
Source: JETRO, *Japanese manufacturers in Asia--ASEAN and India* (2005 survey, carried out January-February 2006).

c) ASEAN FTAs

ASEAN has concluded, or is negotiating, FTAs with India, Australia and New Zealand, and a multilateral FTA with Japan, China and the Republic of Korea. It has also completed joint research on trade relations with the EU and may announce the start of EU–ASEAN negotiations as early as 2006. Through these bilateral and multilateral FTAs, ASEAN is building a solid platform for the supply chain networks of its global corporations.

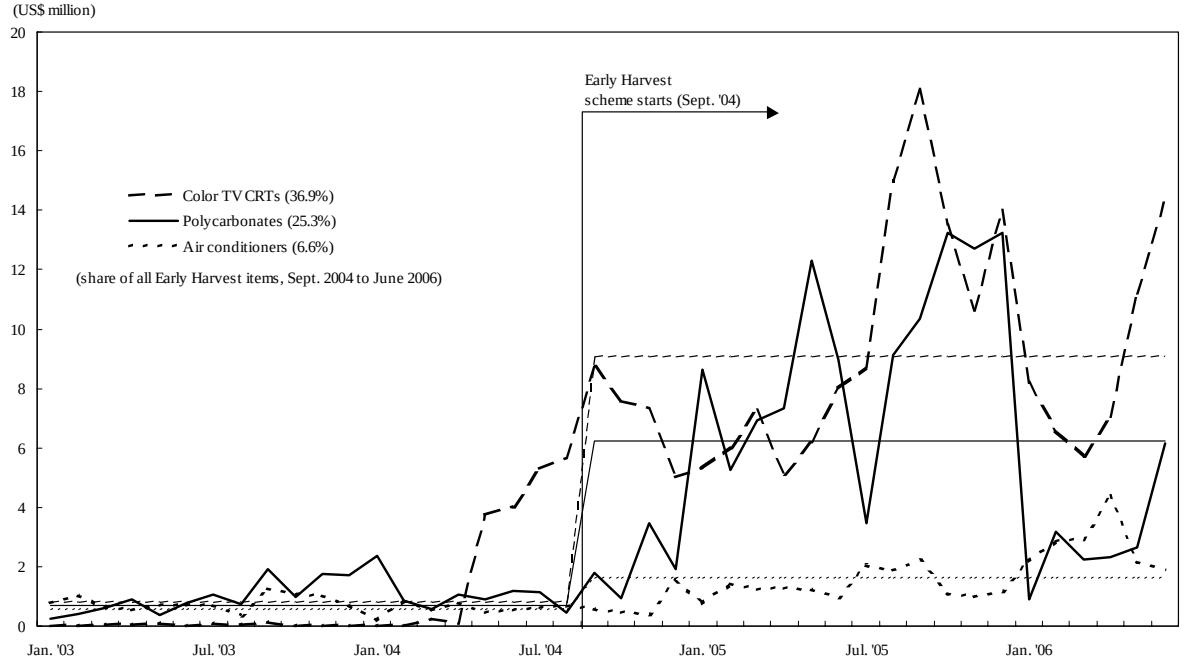
Production in any ASEAN country is expected to satisfy the local production regulations of the three ASEAN Plus One FTAs. These agreements, as well as AFTA, will call for 40% cumulative local content (value-added) as a condition for preferential duties. The 40% rule has inherent problems since local content fluctuates with exchange rates and raw material prices. Since costs must be examined for each model of a product to determine its local content, the system is not well suited to products with short lifecycles. Nonetheless, Japanese corporations experienced in investing in procurement and production systems in the ASEAN region have often been able to cope with such content regulations, and with good reason. The tariff reduction for products satisfying local content rules, for example, has been particularly advantageous for automakers, for which tariffs are relatively high.

The FTA between India and Thailand is a good example of how such agreements can result in increased trade. The agreement, an FTA Early Harvest Scheme designed to accelerate tariff reductions on designated items, went into effect in September 2004. In 2005, Thai exports to India of products under the agreement rose 130% to $337.78 million, a much larger gain than the 67.7% increase in exports of these products from all countries to India. Moreover, the 82 Early Harvest items accounted for over 20% of total Thai exports to India. The top exports were color TV picture tubes, polycarbonates and air conditioners, primarily produced by Japanese corporations in Thailand. Before Early Harvest, India had a 25% tariff on those items, but the rate was reduced to 12.5% when the agreement went into effect, and then further dropped to 6.25% in September 2005. As a result, what had previously been very modest exports increased rapidly thanks to Early Harvest.

Similarly, Thailand's import of Indian products covered by Early Harvest increased 25.5% to $88.29 million. The main import item was gearboxes for automobile transmissions, which were being exported from India by a Japanese-affiliated automaker. Again, Early Harvest brought large tariff reductions: the Thai duty fell from 30% to 15% in 2004, and then to 7.5% in 2005.

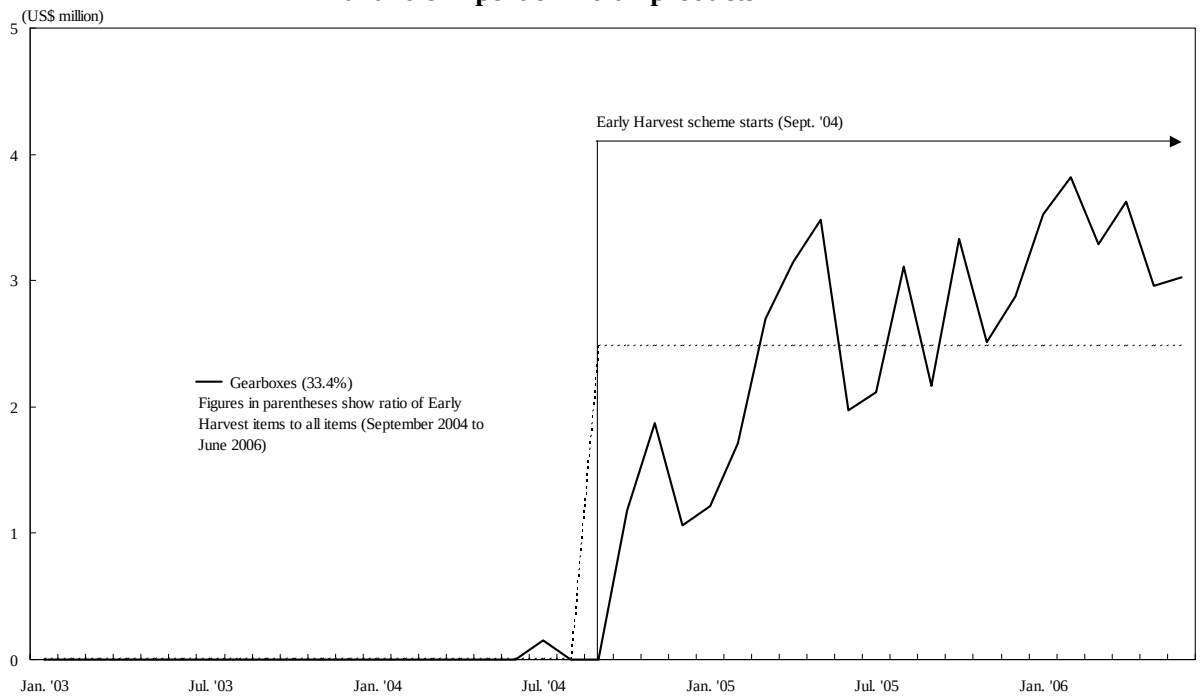
As a result, Thailand recorded a trade surplus with India of $249.49 million on Early Harvest items, a striking change from continual trade deficits up to 2004. The balance of overall Thai–Indian trade was reversed, putting Thailand in the black.

Fig. 44 Trade expansion since Early Harvest Scheme between Thailand and India
-- Thai product exports to India --



Notes: Polycarbonates are HS390740, color TV CRTs are HS852812 and HS854011, and air conditioners are HS841510. Horizontal lines are import averages before scheme (Jan. '02 to Aug. '04) and after scheme (Sept. '04 to Jan. '06).
Source: Customs Office statistics, compiled by JETRO.

Fig. 45 Trade expansion effects of Early Harvest Scheme between Thailand and India
-- Thailand's import of Indian products --



Note: Gearboxes are HS870840. Dotted line is average of gearbox imports in periods before (Jan. '02 to Aug. '02) and after (Sept. '04 to Jan. '06) Early Harvest scheme was implemented.
Source: Customs Office statistics, compiled by JETRO.

2) Value of Alliances with Asian Corporations

Business alliances that leverage the strengths of Asian firms could help Japanese corporations to respond swiftly to rapidly changing markets, particularly in China and India. These alliances, which include both business tie-ups (technical/marketing cooperation, etc.) and capital tie-ups (joint ventures, M&A, etc.), commonly focus on the following objectives:

- Develop new markets (enter foreign markets or gain new corporate customers)
- Combine complementary strengths (maximize existing strengths while making up for specific insufficiencies)
- Mass production (achieve economies of scale not possible alone)
- Launch operations swiftly (accelerate learning curve in local markets).

Often, of course, the alliances reflect multiple objectives being pursued by the partners.

Japanese corporations typically seek alliances with foreign firms due to three basic factors: systemic, corporate resources or external environment.

The main systemic factor is restrictions on foreign capital equity ratios in target countries. Since many Asian countries prohibit foreign companies from being sole owners of domestic corporations, alliances with local partners circumvent this limitation and enable the building of market share.

In terms of corporate resources, the most common factor is Japanese firms' lack of expertise in international operations. Marketing in another country and managing the local corporation require expertise and networks specific to that country. Many corporations fill in the gaps by forming alliances with local corporations. A shortage of necessary corporate resources, particularly human resources, can be another reason to build an international alliance. Japan is experiencing falling birthrates and an aging population, making it difficult for corporations to secure human resources. Since the 1990s, Japanese corporations have made substantial progress in shedding their excess debt, capacity and unemployment left after the bursting of the economic bubble, and are now shifting back to more aggressive management. Yet in many cases they are unable to secure enough young engineers and workers, leaving them no choice but to look overseas for people with manufacturing and product development expertise.

And finally, external environmental factors that are promoting business alliances include the rapid development of regional economic zones around East Asia, which makes strategic tie-ups with international partners an effective way to overcome specific corporate insufficiencies and respond swiftly to changes. Japanese firms have forged alliances in sales, production, development and other fields, especially with Taiwanese, ROK or Chinese firms in rapidly expanding Asian markets, particularly China. They have also been entering the Indian market through alliances with ASEAN firms to utilize their personnel, equity in Indian firms, distribution networks and other Indian-focused assets.

3) Need to Globalize Product Development

Japanese firms also need to overcome their excessive insistence on operating alone. Instead of relying only on internal resources, they must actively seek outside resources and acquire technologies, know-how and human resources from throughout the world, particularly as competition from local and Western firms in East Asian markets heats up. The rapid growth

of the middle class in Asia has created demand for products designed for Western markets, so products are increasingly being launched simultaneously in Asian and Western markets. As a result, success depends on upgrading a company's capacity to develop products for markets worldwide.

The special characteristics of Asian markets, however, must also be kept in mind. In some markets, such as the ROK, Japanese mobile phones and washing machines with sophisticated features are popular, but in many other markets Japanese companies lag behind their Western or Asian competitors in developing products specifically oriented toward local preferences. Some believe that Japanese brand power has not penetrated to the popular level in emerging markets. Brand power exists only when a significant portion of the consumer population is aware of it. If Japanese corporations can popularize their brands by making products that ordinary people in developing countries can buy, they could become more competitive as living standards rise in these markets. That is why it is so important for Japanese firms to build product development bases in these markets and create products that suit local preferences.

Japanese corporations must address product development with the global market in mind while competing successfully in Asia's growing markets. A good model is Nokia, which built a development center in China and introduced inexpensive products to regain the top market share of China's mobile phone market. Nokia has also been successful in introducing products it developed in China to the rest of the world.

Western companies are pursuing three basic strategies to build global R&D systems focused on global-level innovation:

- Use external resources to overcome the "not invented locally" stigma,
- Acquire global technologies, know-how and human resources, rather than focus excessively on home markets, and
- Adopt competitive know-how and technologies from developing nations, rather than assume the unquestioned superiority of those from advanced nations.

JETRO research has revealed a strong trend among Japanese companies to strengthen both marketing and production functions, particularly for general-purpose products, as these firms expand into China, Thailand and other parts of Asia.

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