

# Towards Shortening “Business Cost Distance” in Asia

By Sugie Kazuhiro

## Introduction

Because of the rise in the value of the yen following the 1985 Plaza Accord, Japanese companies began to shift their manufacturing activities to other Asian countries to offset the resulting decrease in international competitiveness. At that time, the low labor cost in Asia justified their overseas operations despite the relatively high logistical costs and under-developed infrastructure.

However, the rise in income levels in Asia that has come about with the high economic growth in the region in recent years means that, before too long, the logic behind the cost-driven division of labor between Japan and other Asian countries will probably no longer prevail. For this reason, in order to develop Japanese corporations’ international business networks in the long-term, it will be important to reduce distribution, travel, and communications costs. This year’s White Paper 2006 focuses on the realities of international business networks in Asia, using what is referred to as the “business cost distance” as an index to measure the cost involved in the flow of production factors, such as people, goods, money and information,

among operational bases.

Based upon the analysis in this White Paper, I would like to point out that for Japan and other Asian countries to create a WIN-WIN relationship, it is important in terms of effectiveness and utility to press forward with the dual-track of trade facilitation measures and tariff reduction.

## Business Cost Distance in Asia

“Business cost distance” represents the financial cost and time required to facilitate the flow of goods, money, people and information between a corporation’s business locations. Weighted indices are used for issues that are considered important in establishing a business network. “Business cost distance” is calculated in terms of distance.

In the White Paper, “the business cost distance” is measured from Tokyo to four other Japanese regional cities and 14 Asian cities indicating that shorter the distance, the easier it is to move the production factors.

Figure 1 indicates “the business cost distance” of the 1980s, when the transfer of Japanese companies’ manufacturing activities to Asian countries began in

earnest, and the current “business cost distance.” All in all, distances between Tokyo and other Asian cities have effectively become shorter because of decreased freight costs, more frequently serviced air routes, and the reduction of information-related costs due to the advancement in IT. Cities such as Singapore, Kuala Lumpur, Bangkok and Sydney have become extremely accessible from Tokyo in the last 20 years. However, Beijing, Chongqing, Ho Chi Minh and Delhi are still very distant.

This means that it will be more expensive for corporations to construct an Asian business network which includes these cities. As a result, the cities will miss out on the opportunity to participate in business networks and, as a consequence, will lose opportunities for economic growth.

## Improvement of Trade Facilitation for Efficient Corporate Activities

Clearly, substantial “business cost distance” is a disadvantage for both the corporations seeking to develop operations in Asia and the cities and countries in question. Improvements are required through efforts on the policy side.

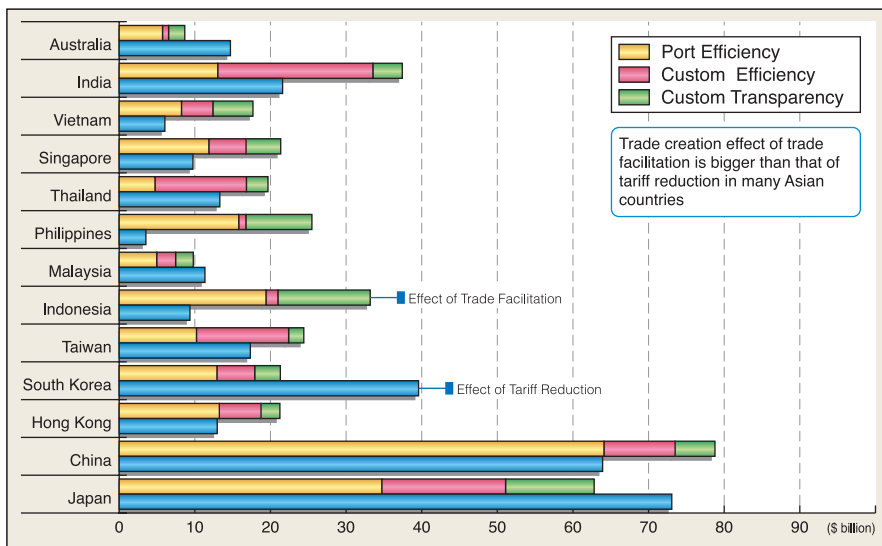
Figure 1 Asian Map Measured by “Business Cost Distance” in the 1980’s and 2005



Source : Research for *Constructing a Business Network in East Asia*, the Research Institute of Economy, Trade and Industry

Notes : The map drawn in green is based on “Business Cost Distance.” The shadow is a map by zenithal projection based on actual geographic distance.

Figure 2 Trade Creation Effect of Tariff Reduction and Trade Facilitation



Sources : World Economic Outlook Database, Direction of Trade, IMF; Trade Statistics, Bureau of Foreign Trade, Taiwan, Chinese Taipei; TRAINS, UNCTAD, etc.

In recent years, the Asia-Pacific Economic Cooperation (APEC) and other similar forum groups have pointed out the importance of improving trade facilitation as a means to enhance the flow of goods. Trade facilitation refers to making customs clearance procedures smoother, ensuring customs transparency, and improving the processing capacity of ports and harbors.

Improving these matters does not contribute directly to cost reductions for corporations, but it does shorten the time required for and improves the predictability of business operations, thereby indirectly leading to cost reductions.

For example, in the main ports of Asia, depending upon the goods, a few days on average are required to complete the customs procedures after entering a port. Considering that it currently takes just under 10 days to ship goods by sea from Tokyo to Bangkok, a considerable percentage of the time for goods to travel from door to door is spent on custom procedures. Consequently, spending time on custom procedures wastes money for corporations that need to maintain their stock levels.

In addition, unnecessary costs may be incurred in the customs procedure, and products or parts might not arrive by the appointed date, because of tariff levels varying from one official to the next, or bribes being requested. These facts can hinder corporations' business develop-

ment.

Such trade facilitation-related problems can become a barrier to the attempts of Japanese corporations to create an efficient production system for developing business in Asia by minimizing inventory levels, through such methods as the just-in-time style of production. Improvement in trade facilitation is therefore an important factor in advancing the establishment of an international business network in Asia.

### The Effect of Trade Facilitation on Expanding Trade

Exactly how great an influence does improved trade facilitation have on trade? Focusing on improvements in port efficiency, customs efficiency, and customs transparency, I carried out tentative calculations to determine, whereby if the countries and regions of Asia that are currently below the average level in these three categories were lifted to the average, to what extent the total trade for these Asian countries and regions would expand. I then compared that with the trade-creation effect of tariffs being abolished in the Asian region.

Figure 2 illustrates the calculated effect and the following three points.

First, Japan's level of trade facilitation is higher than the average; thus, while there may be no need to make improvements, the trade-creation effect is the

second largest after China. China definitely needs to improve these categories of trade facilitation.

Second, the extent of improvement in these categories varies greatly depending upon the country or region. For example, in India the effect of improved customs efficiency is greatest, whereas in Indonesia the effect of port efficiency is greatest.

Third, in Japan, while the effect of the abolition of tariffs is greater than that of improvement in trade facilitation, for most countries and regions of Asia, improved trade facilitation is far more effective in terms of expanding trade.

### Creating a WIN-WIN Relationship with Asia

The above mentioned results suggest the following in terms of creating a WIN-WIN relationship between Japan and Asia.

First, it is important that Japan press ahead to improve trade facilitation in the countries and regions of Asia through official development assistance (ODA) and economic partnership agreements (EPAs). This will bring about benefits in terms of expanded trade for Japan and its Asian trading partners as well.

Second, in order to make progress towards EPAs with the countries of Asia, it is necessary both to reduce tariff controls and to improve trade facilitation. As seen above, while a reduction in tariffs should bring about a large trade-expansion effect for Japan, this is not the case for the other countries and regions of Asia. An improvement in trade facilitation is necessary in Asia for both sides to enjoy the benefits of EPAs. Because trade facilitation is for the general public good, in comparison with tariff reductions for individual items, it is easy for the interested parties to reach an agreement and, therefore, offers an effective means of promoting negotiations. **J.S**

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