Regional Services “Hub” Strategy and Regional Services Agreements

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Overview

• Differences between goods and services trade.

• Overview of services FDI into ASEAN (balance of payment)

• Actual business model of Japanese services firms.

• Policy implications.
Logic of “Hub”

- Goods and services are very different in terms of the effects of regional agreements.
  - Goods: Strict ROO to avoid trade deflection.
  - Mode 3 services trade ROO is “leaky”: Substantial business operation ROO.

- Therefore, unlike goods, trade deflection may happen in the case of services.
Determinants of Services “Hub”

- Two determinants of “Hub”:
  - Whether services trade is liberalized within a region.
    - Whether Agreement that includes Country S and I is substantial.
  - If “Yes”,
    - Which country is the most attractive FDI destination.
      - Actual regulations (of S and I)
      - Commitments in regional services agreement with external parties (S-J Agreement; I-J Agreement)
Questions

• Therefore:
  – Services suppliers strategically decide the location of services FDI
  – “Hub” strategy seems to work well in the case of some services.

• Then, the questions are:
  – Which country in a regional group (ASEAN) receives services FDI from outside, as a regional services “Hub”?
    • We will examine Japanese services FDI.
  – Are there any differences across sub-sectors?
Trend of Japan’s Manufacturing FDI into ASEAN

Amount

Share

-40%
-20%
0%
20%
40%
60%
80%
100%
2005 2006 2007 2008 2009 2010

Other ASEAN
Vietnam
Philippines
Malaysia
Indonesia
Thailand
Singapore
Trend of Japan’s Services FDI into ASEAN

Amount

Share

(billion yen)

2005 2006 2007 2008 2009 2010

2005 2006 2007 2008 2009 2010

-20% 0% 20% 40% 60% 80% 100%

Other ASEAN
Vietnam
Philippines
Malaysia
Indonesia
Thailand
Singapore
Japan’s Transportation FDI into ASEAN

Amount

Share

(billion yen)

Other ASEAN
Vietnam
Philippines
Malaysia
Indonesia
Thailand
Singapore
Japan’s Finance FDI into ASEAN

Amount

(billion yen)

2005 2006 2007 2008 2009 2010

Share

2005 2006 2007 2008 2009 2010

Other ASEAN
Vietnam
Philippines
Malaysia
Indonesia
Thailand
Singapore
Comparison between Transportation and Finance

• Thus, we can say that:
  – Transportation FDI: Concentration in Singapore
  – Finance FDI: There is no concentration

• Why?
  – Whether services trade is liberalized within a region.
  – Which country is the most attractive FDI destination.
ASEAN’s Plan of Transport Sector Liberalization

- Logistics will be liberalized as a priority sector.
  - Mode 1: full liberalization by 2013
  - Mode 2: full liberalization by 2013
  - Mode 3 (foreign equity cap)
    - 49% by 2008
    - 51% by 2010
    - 70% by 2013
    - 100% by 2015
Actual Liberalization of Transportation Sector

• Singapore
  – Already fully liberalized.

• Thailand
  – Multimodal Transport Act 2005 – some argue that treatments of foreign firms unclear.
  – Simply follow ASEAN’s plan.

• Philippines
  – The Constitution maintains strict foreign equity cap on public utilities/services (not more than 40%).

• Indonesia
  – Regulations seem to be complicated
    • Currier versus express delivery
    • Currier services are under:
      – Postal low
      – Ministry of transportation orders
      – Ministry of Communication and Information Technology orders.
## Transportation Commitments in EPAs with Japan

<table>
<thead>
<tr>
<th>Sectors or sub-sectors</th>
<th>Singapore</th>
<th>Thailand</th>
<th>Philippines</th>
<th>Indonesia</th>
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<tbody>
<tr>
<td><strong>A. Maritime Transport Services</strong></td>
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<tr>
<td>a. Passenger transport (7211)</td>
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<td>c. Rental of vessels with crew (7213)</td>
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<td>d. Maintenance and repair of vessels (8868**)</td>
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<td>e. Pushing and towing services (7214)</td>
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<td>f. Supporting services for maritime transport (745**)</td>
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<td><strong>B. Internal Waterways Transport</strong></td>
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<td>b. Freight transport (7222)</td>
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<td>c. Rental of vessels with crew (7223)</td>
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<td>f. Supporting services for internal waterway transport (745**)</td>
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<td><strong>C. Air Transport Services</strong></td>
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<td>b. Freight transport (732)</td>
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<td><strong>D. Space Transport (733)</strong></td>
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<td>b. Freight transport (7112)</td>
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<td>c. Pushing and towing services (7113)</td>
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<td>d. Maintenance and repair of rail transport equipment (8868**)</td>
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<td>e. Supporting services for rail transport services (743)</td>
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<tr>
<td><strong>E. Rail Transport Services</strong></td>
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<td>a. Passenger transport (7121+7122)</td>
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<td>b. Freight transport (7123)</td>
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<td>c. Rental of commercial vehicles with operator (7124)</td>
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<td>d. Maintenance and repair of road transport equipment (6112+8867)</td>
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<td>e. Supporting services for road transport services (744)</td>
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<tr>
<td><strong>F. Road Transport Services</strong></td>
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<td>a. Transport of fuels (7131)</td>
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<td>b. Transport of other goods (7139)</td>
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<td>a. Cargo-handling services (741)</td>
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<td>b. Storage and warehouse services (742)</td>
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<tr>
<td>c. Freight transport agency services (748)</td>
<td>X</td>
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<tr>
<td><strong>H. Services auxiliary to all modes of transport</strong></td>
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<tr>
<td>a. Cargo-handling services (741)</td>
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<td>b. Storage and warehouse services (742)</td>
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<td>c. Freight transport agency services (748)</td>
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<td><strong>I. Other Transport Services</strong></td>
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ASEAN’s Plan of Financial Sector Liberalization

- Plan of liberalizing financial services under AEC Blueprint in 2007 is not ambitious.
  - Progressively liberalize restrictions in sub-sectors or modes as identified by each member country by 2015
  - Progressively liberalize restrictions in the remaining sub-sectors or modes, which are not identified under “pre-agreed flexibilities” by 2020.

<table>
<thead>
<tr>
<th></th>
<th>Singapore</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Thailand</th>
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<tbody>
<tr>
<td><strong>Banking</strong></td>
<td>100%</td>
<td>99%</td>
<td>49%&gt;70%</td>
<td>60%/40%</td>
<td>25&gt;49%</td>
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<tr>
<td><strong>Insurance</strong></td>
<td>100%</td>
<td>80%</td>
<td>49%&gt;70%</td>
<td>100%</td>
<td>25&gt;49%</td>
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**Foreign equity cap**
Difference between Transportation and Finance

- **Transportation**
  - Liberalization within ASEAN is substantial.
  - Hub strategy works.
  - Singapore is the most attractive destination in terms of: (1) actual regulations and (2) services commitments.
  - Singapore becomes “hub”.

- **Finance**
  - Liberalization within ASEAN is insubstantial
  - Hub strategy does not work.
The Case of Yamato Transport Co., Ltd.

ROH in Singapore
- The company recently decided to establish an ROH for the ASEAN region in Singapore.
- Singapore Yamato was transformed into Yamato Asia in November 2009.

Business Model
- The plan is that Yamato Asia will develop an express parcel business, in particular, "B to C" business in Singapore as well as other ASEAN countries.
- Yamato Transport is expecting that Japanese retailers specializing on mail order business will start their operation in Southeast Asia in the near future, using services provided by Yamato.
  - Parcel business is increasing significantly due to the spread of mail order purchase.
The Case of Mitsui Sumitomo Insurance Co., Ltd. (1)

Commercial Presence in ASEAN

- In 2004, Mitsui Sumitomo purchased 25% of shares in Asia Insurance (Cambodia) Limited.

- In August 2008, Mitsui Sumitomo established fully-owned local subsidiary in Vietnam
  - The first 100% Japanese-owned accident insurance company approved by the Vietnamese government.

- In April 2009, Mitsui Sumitomo also established a subsidiary in Lao PDR
  - The first Japanese insurance subsidiary in the country. Mitsui Sumitomo holds 51% share while Lao Finance Ministry owns 49%.
  - This was achieved soon after the Lao government liberalized the establishment of insurance subsidiary in 2007.

- In June 2010, MSIG Insurance (Malaysia) merged with Malaysia’s Hong Leong Assurance Bernard, becoming the second largest in the country.
  - Mitsui Sumitomo will hold 70% of the shares of the newly-transformed MSIG Insurance (Malaysia), while Hong Leong will hold 30%.
The Case of Mitsui Sumitomo Insurance Co., Ltd. (2)

Business Model

- The plan is to establish subsidiaries in all ASEAN countries where foreign general insurers are permitted to get a license.
- Mitsui Sumitomo Insurance needs to expand its overseas business to make profit and to compete with Tokyo Maritime.
- The company’s overseas premium income recorded a sharp increase in recent years
  - One third of the increase (2001FY-2007FY) in the company’s total premium income is earned in Asia.
  - The company’s overseas business plan is to achieve half of sales in Asia, 30% in Europe and 20% in the US.
Policy Implications

• If services and investment are liberalized within a region:
  – You should minimize the restrictions on FDI from outside.
    • This is because, otherwise, outside investors simply chose other country to supply services to your country.

• When a partner decides to liberalize trade and investment in a certain service sector where the hub strategy works:
  – It is important for you to liberalize the sector toward outsiders as well.
    • Otherwise, investment deflection will happen.
Possibility of Generalization

• Other than transportation, “hub” strategy may work:
  – Communication
    • Courier and value added telecommunication.
  – Distribution
    • wholesale in particular.
Further Details

- ADBI Working Paper No. 267
- *Journal of World Investment and Trade*, Volume 12, Issue 3