
Production Issues Analysis Team Research Report

Perspectives on the Cross-Border Division of Production in the Mekong Region

-With a Focus on the East-West Economic Corridor-¹

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1. Introduction

Among ASEAN member countries, those located on the Eurasian mainland (Vietnam, Laos, Cambodia, Thailand, and Myanmar) are considered to be in a target region for cross-border division of production. In fiscal 2014, the author conducted an on-site survey of the so-called east-west economic corridor linking central Vietnam and central Laos. This was part of the research activities funded by a grant from the Japanese Ministry of Education, Culture, Sports, Science and Technology (MEXT)-Supported Program for the Strategic Research Foundation at Private Universities. The east-west economic corridor refers to the distribution route that connects the area around Da Nang in central Vietnam to the area around Savannakhet in central Laos.

The author's research included interviews of local companies regarding the current situation of the east-west economic corridor as a major shipping artery linking Thailand and China, which has a large market. Thailand will be raising its profile as a production base for machinery and equipment (particularly transportation equipment) as a result of the ASEAN Free Trade Area (AFTA), a free trade pact within the ASEAN region that will lower tariffs and enable free trade by 2015. This paper is a summary of the author's findings.

2. Transportation Conditions Along the East-West Economic Corridor in Laos and Vietnam

In September 2014, the author visited Da Nang in central Vietnam, which is the starting point of the Mekong region's east-west economic corridor, and Savannakhet, a relay point along the Laos-Thai border. As is well known, the east-west economic corridor is the route connecting the continental ASEAN nations of Vietnam, Laos, Thailand, and Myanmar as ASEAN economic integration proceeds. In fact, the author

chartered a bus and took a trip along this route. It took 12 hours for the bus to go from Da Nang to Savannakhet and 11 hours for it to return from Savannakhet to Da Nang. This included five 20-minute rest stops, so a truck hauling container freight could probably make the trip an hour faster.

After departing from downtown Da Nang, the bus heads north on National Route 1 for about three hours until it reaches the coastal city of Dong Ha. En route lies the ancient capital city of Hue, but here the bus takes a shortcut to bypass the city, and at Dong Ha, it turns west onto National Route 9. Route 9, as it is known in both Laos and Vietnam, was built with economic cooperation from the Japanese government.ⁱ

i This paper is the result of a survey conducted in fiscal 2014 with a grant from MEXT-Supported Program for the Strategic Research Foundation at Private Universities. In addition, it is a drastically revised version of Prospects for the Overland Shipping Network and Machinery Production Bases in the Mekong Region, which appeared in the October issue (electronic edition) of the Japan Machinery Center for Trade and Investment's *Emerging Markets* journal, and it appeared in the "Research Notes" section of the March 2015 issue of the *Senshu Business Review*, which is published by Senshu University's Institute for Commercial Studies.

This road was planned as a shipping route ultimately connecting Da Nang, Vietnam, in the east and the port of Mawlamyine, Myanmar, in the west.

Road work to widen the section consisting of Route 1 between Da Nang and Dong Ha in Vietnam from one lane in each direction to two lanes in each direction is moving full speed ahead. Shipping overland should become easier in the near future. Still, the road in Vietnam (Route 1) is full of motorbikes and has speed limits. On the other hand, in Laos (Route 9), there are no speed limits per se, but there is only one lane in each direction and the shoulder is narrow. It is also a community road, so that under the best of circumstances vehicles can go only 70-80 kilometers per hour at most and cannot drive as they are on a limited-access roadway or an expressway. Trucks are frequently seen loaded down with containers on this corridor thoroughfare. Although not as frequent, some have belonged to Japanese-affiliated shipping companies. Some sections of the road are unpaved or the asphalt is disintegrating, producing potholes, so that drivers have to slow down. However, apart from this one section, it seems that the condition of the road is fine. It appears that the road will be increasingly used as a shipping artery over time.



Photo 1: Container yard in Da Nang Port (taken by the author).

As described above, it seems that as far as the Vietnam-Laos segment of the east-west economic corridor is concerned, the roadside infrastructure is gradually improving. The road also has Japanese-style rest stops. Those along the segment between Savannakhet, Laos, and Da Nang Port, Vietnam, are reaching a level at which they can be used regularly with no problems. According to the branch manager of a major local shipping company in Savannakhet (headquartered in Vientiane, Laos), Japanese-affiliated companies are among the freight owners using the Da Nang-Savannakhet route to ship electronics and machinery components.ⁱⁱ Although issues remain in terms of road maintenance, simplification of customs procedures, and insufficient know-how for handling freight among local shipping companies, these will probably be resolved over

time. On the other hand, according to an interview with the Da Nang Port Authority, freight currently being shipped from the port of Da Nang via the east-west economic corridor and other overland routes amounts to only 2% of all freight passing from Vietnam into Laos.ⁱⁱⁱ This seems to mean that this shipping route is still not the "preferred" route.

The city of Savannakhet, the terminus of the east-west economic corridor in Laos, is situated on the Mekong River. As will be mentioned later, it has gradually become a site for Japanese companies to locate plants in recent years. On the opposite bank of the Mekong River is the city of Mukdahan in northeastern Thailand. The bridge spanning the river at the border is the Second Friendship Bridge, built with Japanese economic aid. West of Mukdahan, the road transverses northern Thailand until it finally reaches Myanmar, while turning left at Mukdahan and traveling southward, another road leads to the eastern coastal region around Laem Chabang and Rayong, which is one of Thailand's major industrial areas.

Savannakhet is well known in Japan for being the city where such major Japanese corporations as Nikon and Toyota Boshoku have set up operations. It is the location of the Savan Seno Special Economic Zone (developed with funds from Malaysia and Laos). This industrial park is home to about 40 companies, of which eight are Japanese affiliates. Fifteen of the companies are Laotian, followed by nine from Thailand. Four of the eight Japanese companies are machinery and equipment makers. The products manufactured here are not only shipped across the border to neighboring Thailand, but are also increasingly being transported more than 500 kilometers to Da Nang.^{iv} By the way, the distance between Savannakhet and Da Nang is about 250 kilometers in Laos and about 250 kilometers in Vietnam. About 500 kilometers in all. If companies can benefit from moving their labor-intensive processes to low-cost regions utilizing existing plants, this kind of overland shipping route in the Mekong region countries holds great potential. At present, instances of Japanese companies closing down their labor-intensive operations in Thailand and moving them to Laos or Cambodia are still not very frequent. However, this trend is likely to progress as other shipping routes are completed and more choices are available.



Photo 2. Open air market on the Vietnam side of the Vietnam-Laos land border (taken by the author).

On the other hand, according to the Savannakhet Transportation Bureau, some shippers are using alternative routes to the east-west freight network to ship freight to Vietnam.^v National Route 12 runs north of and almost parallel to the east-west economic corridor, going from northeast Thailand directly through northern Vietnam to the capital city of Hanoi and then on to Guangzhou in China. National Route 13 runs from north to south along the Mekong River, starting in Udon Thani in northeast Thailand and continuing on to Vientiane, the capital city of Laos, then due north to Kunming, the capital of China's Yunnan Province. Both the east-west and north-south routes are drawing traffic. For example, the north-south route is said to be popular with Chinese companies.^{vi}



Photo 3. Rest stop constructed with Japanese aid along the east-west economic corridor in Laos (taken by the author).

Another east-west shipping route in the Mekong region is the so-called southern economic corridor, which runs from Thailand’s eastern coastal area through Cambodia and then turns east to Ho Chi Minh City in southern Vietnam. This is another popular alternative to the east-west economic corridor. Connecting Bangkok and Thailand’s eastern coastal area with Phnom Penh, Cambodia, and Ho Chi Minh City, Vietnam, this road has many special economic zones (SEZ, one of the types of industrial parks) springing up along its path, which is shown below. This route is gaining popularity along with the east-west economic corridor that the author rode on.

Table. Numbers of SEZ and Japanese-Affiliated Companies Along the Southern Economic Corridor

SEZ	Location	Number of Japanese Affiliates (Companies)
Phnom Penh	Phnom Penh	36
Sihanoukville Port	Sihanoukville	1
Sihanoukville	Sihanoukville	2
Manhattan	Near the border with southern Vietnam	1
Tai Seng	Near the border with southern Vietnam	15
Koh Kong	Near the southern border with Thailand	2
Poi Pet	Near the border with central Thailand	0

Source: Nobuo Hirobata, Factors Determining the Location of Japanese Firms Entering Cambodia, paper delivered at the Japan Scholarly Association for Asian Management’s 21st Annual National Research Symposium, September 14, 2014.

3. Perspectives on “China+1” and “Thailand+1” Among Japanese Manufacturers

The east-west economic corridor and southern economic corridor are material to the so-called “China+1” or “Thailand+1” concepts, which support the idea of having an additional manufacturing base in Asia to counter rising costs in Thailand and risks in China. The focus of such efforts are the Mekong region countries of Vietnam, Cambodia, Laos, and Myanmar, which is about to embark on economic reform and open-door policies. Japanese companies are steadily increasing their presence in these countries.

In recent years, the metropolitan areas of Ho Chi Minh City and Hanoi in Vietnam have seen the development of many industrial parks for attracting industries ancillary to manufacturing, and in particular to machinery and equipment production, along with

industrial technology transfer. Vietnam is said to currently have about 200 industrial parks. Some of them have received direct investment from Japanese companies, and these industrial parks with Japanese capital participation (from trading companies, construction companies, and the like) are focused on attracting not only the major Japanese machinery makers but also SMEs that make machine parts. Myanmar and Vietnam are also making progress with infrastructure improvement, thanks to infrastructure development assistance and other aid from the Japanese government and Japanese trading companies. This should result in even more Japanese-affiliated companies entering these countries.^{vii}

Industrial park plant sites have been shunned because of the high land rents, but many industrial parks generally have small land areas with factory buildings ready to be leased out as “rental plants.” These are intended to attract SMEs that possess technology, i.e., ancillary industries. The procedures for renting a plant are simple, from selecting the land to actual move-in. Resident companies can expect to receive incidental services from an on-site management company, so this set-up is good for SMEs. It will likely encourage companies to move into the industrial park. However, some SMEs have opted to locate their plants in more remote areas, where land rents are cheaper and where they need not worry that workers they have taken the time to train will be lured away by neighboring plants in the industrial park. Vietnam has a number of SMEs that have succeeded after entering the local market in this way.^{viii}

Textile companies and medical supplies makers have been operating in these countries where costs are low for a while, but more recently the number of machinery parts makers, both large and small, has been steadily growing. The Vietnamese government seems to be particularly interested in attracting these types of Japanese SMEs. It is no longer rare to see officials from Vietnamese industrial park operating companies making the rounds of regional chambers of commerce and industry in Japan with the object of drumming up business from SMEs. Many of these industrial parks have also hired Japanese consultants to help them tailor their operations to the needs of Japanese companies.

Cambodia and Laos are becoming popular sites for setting up of assembly plants. A Japanese precision parts maker located in the Phnom Penh SEZ’s industrial park (owned by Malaysian and Japanese interests) imports parts from its plant in Thailand, finishes the labor-intensive part of the production process in Cambodia, and then ships the finished goods back to Thailand. Upon visiting this plant in February 2014, this author noticed that many Thai foremen from the plant in Thailand were working there.^{ix}

It appeared that the Cambodian plant was performing the same production management and quality control processes that have been in place at the Thai manufacturing facility for many years. The finished goods (or parts) made by this manufacturing process were supplied to the Thai assembly plant (main plant) via an established land route. The branch plant's materials are all sourced in Thailand. This branch plant is the culmination of 20 years of know-how developed overseas and is operated according to Cambodian customs. In addition, the plant offers primary education and teamwork courses and sponsors employee appreciation activities and other employee participation events, including inviting the families of its top-performing workers to awards ceremonies. These efforts on the part of plant management have borne fruit in the form of higher productivity. The plant has received local acclaim for its emphasis on primary education for its workers. It also provides company housing for employees, which is run by a staff of 13 Japanese and 13 Thais transferred from the plant in Thailand.^x



Photo 4. A long-distance container truck parked in the truck yard of a major Laotian shipping company in Savannakhet (taken by the author).

In this region, the countries with the lowest labor costs are Myanmar and Laos. Many of Laos's major cities are situated near the Thai border. Even though the domestic transportation networks of Laos and Cambodia are inadequate, locating in a city near the border allows trucks carrying raw materials and parts to easily access the better-maintained highways of Thailand and Vietnam. This enables companies to receive the benefits of both low labor costs for the manufacturing process (in Laos and Cambodia) and a developed transportation network (on the Thai and Vietnam borders). So far, only a few plants making machinery parts and the like have located in this area, but the numbers are likely to increase.

4. Conclusion

Production costs continue to rise in China, Thailand, and other areas that have been indispensable to Japanese production activities. Even if it is reasonable to continue making products there for domestic consumption in those countries, these places are losing their former attraction as bases for exporting to a third country. This is particularly true in China, where political risk is high and the investment climate has lost its attraction for manufacturing. Instead, Vietnam and Myanmar have become strong candidates for plant sites. In addition, Laos and Cambodia are becoming popular as sites for branch plants of main plants in Thailand. The overland traffic routes will be key to the liberalization of trade (i.e., economic integration) of these countries, which are separated by land and river borders.

Vietnam's population is currently 90 million and will reach 100 million in the near future. This country will be the core state for the transport of physical and human resources as free trade progresses with the completion of the ASEAN Free Trade Area (AFTA) in 2015. With its long land border, Vietnam is expected to grow as a starting point and terminus for fine small-lot shipments to Laos and Cambodia and, via northern Thailand, to Myanmar, Bangladesh's 200 million people, and India's 1.2 billion people (especially the area around Kolkata in the northeast), without passing over the Malay Peninsula or through the Straits of Malacca. As discussed in this paper, it is highly likely that production facilities and shipping and storage facilities will be established along this route. This in turn will lead to urbanization and the concomitant formation of distribution markets. Based on this outlook, further research into the integration of companies' shipping, production, and distribution functions is essential to a survey of the business climate in this region.



Photo 5. Shopping mall in Savannakhet. However, there are few occupants (taken by the author).

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- Footnotes:**
- i. This is said to be the route of the so-called Ho Chi Minh Trail, a mountain road built in the 1970s so that the North Vietnamese government could supply materiel to the “Vietcong troops” in South Vietnam.
 - ii. Interview with a Japanese-affiliated company in Da Nang City, September 5, 2014.
 - iii. Interview with the vice-president of the Da Nang Port Authority, September 5, 2014.
 - iv. Interview with a local shipping company in Savannakhet, September 8, 2014.
 - v. Interview with the director of the Savannakhet City Government’s Transportation Bureau, September 8, 2014.
 - vi. “Changes made to the route between China and Laos – travel time has been shortened from 10 days to 3 and the single lane road into multiple lanes,” *Laotian Chinese Business Wire*, pp. 26-27, July 2014”
 - vii. Japanese companies are at the top of the list of foreign companies targeted by Da Nang City.
 - viii. Interview with a Japanese-affiliated company in Ho Chi Minh City, February 16, 2014.
 - ix. Interview with a Japanese-affiliated electronics components maker in the Phnom Penh SEZ, February 16, 2014.
 - x. As a tragic legacy of the Pol Pot era in Cambodia, primary education is still not widespread. As this lack of education also affects productivity, this plant is conducting basic education on plant premises at certain times, February 17, 2014.