

## **Executive Summary**

### **Direction of Chinese Economic Reform and Main Proposals**

#### **Hope for intensifying the reform in the 13.5 Plan.**

In the 13<sup>th</sup> 5-year Plan (hereinafter referred to as the 13.5 Plan) the government is focusing on outstanding issues such as inequality/disharmony/unsustainability of growth toward full-scale completion of a moderately prosperous society. It states it will deal with firm establishment and through realization of 5 growth philosophies; namely, Innovative development, coordinated development, green development, open development and shared development.

In regard to this, it emphasizes again to promote structural adjustments through the reform and the importance of the role that the market plays in the 13.5 Plan, Japanese companies hope that 2016 will be the year the intensifying of the reform will be carried out that leads to the improvement of the business environment with “high transparency” where “non-discrimination” is secured. At the same time they are ready to actively contribute to the Chinese government in intensifying the reform and realizing the 5 growth philosophies through various businesses.

The 13.5 Plan stipulates the Chinese government will intensify the reform with the aim to complete the development of a modern market system, to intensify the reform of the administrative management system and to complete the development of the system that is open to the international community. In view of this we have organized the issues that Japanese companies are facing in the business scene in China by various fields as follows.

This white paper compiled recommendations to analyze and solve issues that Japanese companies, who have been engaged in business across China over a long period of time, have been facing. Upon intensifying the reform, we believe this white paper contains many useful proposals We hope it will be of some reference to future policy administration.

#### **Improving the Modern Market System**

In the 13.5 Plan, it has emphasized to thoroughly reorganize/abolish various regulations and methods that are obstacles to uniformed market and fair competition, to implement a screening system to allow fair competition, and to ease market entry restrictions. Along with this direction, this white paper requests reviewing various systems that are obstructing fair competition in line with the market economy to adequately leverage the market principles.

• **Investment** : As for the non-transparent system operation issue, this is viewed as the risk for foreign-owned enterprises to invest in China. We request improvement in uniform application of the interpretation of the legal system, an adequate preparation period for system changes, simplifying/expediting various procedures, foreseeability such as replying in writing for application/inquiries etc.

• **Energy Conservation and Environment Protection** : From the viewpoint of effectively implementing countermeasures against environmental regulations, we request implementing a mechanism to prove conformity by the manufacturers themselves (Declaration of Conformity) by following developed companies. For example, in the case of the assessment system (evaluation for certification) for the Restriction of Hazardous Substances for Electric/Electronic Products (China RoHS), it will make it possible to reduce the burden across the supply chains, at the same time effectively reduce harmful substances by implementing the Declaration of Conformity.

• **Logistics** : Though the restriction on handling hazardous goods of international transport arrangement is being tightened, detailed restriction contents are not disclosed and interpretation of the handling is not uniform in different regions, customs and quarantine offices, hence it is greatly hindering transportation arrangements. We request not only tightening the restriction in vein but take appropriate countermeasures that take the effect on business in consideration as soon as possible.

Furthermore, in the 13.5 Plan, it showed the determination of completion of developing the intellectual property right system that is beneficial to promote innovation. Moreover, it emphasizes to intensify the reform in the field of intellectual property rights and to enhance judiciary protection. In 2015, various initiatives were carried out such as trials in “Intellectual Property Court”. However, counterfeiting is getting more sophisticated and complicated, there are still strong calls for improvement of intellectual property issues. We request appropriate countermeasures according to the change of the situation.

• **Protection of Intellectual Property** : We request tightening the intellectual property protection system by internet service provider (ISP) by speedy deletion of sites that sell counterfeit products and to restrain repeated offences. Furthermore, we request Chinese ISP to collaborate with international ISP to take measures to work together.

- **Protection of Intellectual Property** : As for "Antitrust Guidelines related to Abuse of Intellectual Property" proposal, we request clarifying the basis for assuming abuse of intellectual property, thus it will make it difficult for proper exercise of intellectual rights to be regarded as abuse of intellectual rights.

### **Deepening the Reform of the Administrative System**

It was emphasized in the 13.5 Plan, that the government will create open, transparent, effective and speedy fair governmental services for all by intensifying the reform of the administrative examination/approval system, reducing the interference to corporate management by the government, and the maximum scale down of examination/approval items. All departments of State Council are reinforcing innovation for further management and governmental services by abolishing 311 administrative examination/approval items or transferring to lower departments in 2015.

We request further positive development of simplifying/expediting administrative procedures, abolishing permits/licenses and authentication, and enhancement of governmental services, as Japanese companies continue to call for in many fields in this white paper.

- **Trade** : HS number of the same product, the custom examination related to export and import declarations such as certificate of origin etc., operation and the interpretation of rules and regulations of free trade zones, logistic zones and free trade ports differ depending on the region and the person in charge. We request unified nationwide operation by enhancing trainings and establishing more detailed manuals etc. We also request the establishment of a user-friendly system for enterprise by implementing a unified HS number advance ruling system. At the same time, we request releasing documents that interpret the items subject to HS numbers in details. We also request unifying necessary documents, time required at the time of permission related to entering to port, docking and loading as much as possible.

- **Office Equipment** : Same testing is required in different certification. For example, to obtain CCC certificate and NAL certificate, EMC testing and Surge Test are required in both certifications and the same tastings have to be carried out twice. We request the improvement such as being able to use the test results for both certifications, since the current system burdens enterprises unnecessarily by costing them twice.

- **Wholesale Industry** : The lack of compliance awareness by some wholesalers is causing

lower competitiveness of companies that observe compliance. For example; there are cases of; 1) the loss of credibility of online sales websites because of traders that sell counterfeit products or selling products unfairly cheap, 2) the existence of traders that ask for a charge with presumption of excessive load and 3) the existence of traders that present delivery quotes without tax on the premise of not issuing tax receipts. We request the reinforcement of the control of unauthorized traders for the sound development of the industry.

Moreover, in the 13.5 Plan, it emphasized that the government will construct a multilayered, extensive and differentiated banking system to encourage expansion of private capital participation of banking business. We welcome bold initiatives aiming for development and reform. Various developments to improve the multilayered financial market and financial products have been observed such as introduction of a deposit insurance system, abolition of upper limit of deposit interest rate, expanding liberation of the banking industry such as approval of incorporation for private banks etc. However there are still some restrictions centering on capital transactions, hence we request acceleration of further liberalization.

- **Banking** : Along with the financial reform that was proposed in the Third Plenary Session in 2013, deregulation of interest rates and foreign exchange rate and various reforms related to developing a multilayered capital market are making rapid progress. We understand marketing of interest rates, the liberation of RMB-denominated capital transaction etc. will be accelerated further. Since these financial deregulations are believed to have a great impact on the real economy and corporate activities in China and the business environment of the financial sector, we request realization/clarification of the schedule and the road map of the future deregulation reform.

- **Banking** : The loan-deposit ratio was abolished in October 2015. On the other hand, the deposit divergence control, that controls the daily average of monthly balance and the monthly balance, remains to date and it restricts corporations to gain access to funds so as to expand business in the Mainland China Market. It is understood that the deposit divergence control is there to prevent banks from illegal deposit funding etc. however, since the deposits are the asset of the clients, and it is difficult for banks to control the balance that is associated with normal movement of liquid deposits, especially at the end of the month when there are many settlement transactions, we request a deregulation of the deposit divergence control.

Furthermore, in the 13.5 Plan, it is emphasized to establish a promotion mechanism that requires energy conservation, environment protection and safety etc. as prerequisites, implementation of the strict system to protect the environment and form the system for environmental measures that the government, corporates and the public control together.

It is understood that these initiatives are imperative for China to achieve sustainable development. We request enhancement of scientific legitimacy, securing an adequate preparation period, and the construction of an efficient mechanism (such as Declaration of Conformity that has become the mainstream in advanced countries) when implementing regulations.

- **Energy Conservation and Environment Protection** : In the process of formulating policies/laws/projects related to the environment/energy conservation, we request that the government shall proceed with adequate communication with related industries including foreign-owned corporations. As for the procedures etc., we request securing transparency/fairness. Furthermore we will continue to request the development of detailed administrative instructions, the clarification of interpretations and the definition of contact points for inquiry related to regulations. We also request further development as the initiatives are gradually progressing

- **Cement Industry** : With the implementation of the new Environment Protection Law in January 2015, it became the most strict standard in the world for emission of pollutants such as SOx and NOx etc. that regulates uniformly regardless of industries. As for Japanese companies, we are going to actively take these measures to become the precedent example. However, as for the application of the laws, we request that the average value of a certain period time as the regulation index which takes into account engineering variations, rather than an unreasonable index that does not allow for momentarily exceeding the standard values.

### **Improving the New System for Opening Up**

In the 13.5 Plan, it is stipulated the thorough implementation of the market environment where fair competition exists, realization of fair and transparent application of the laws, liberation and innovation of service/financial sector. Initiatives for China to become a more open market are progressing, for example, the Foreign Investment Acts is being formulating assuming “National Treatment before Entry and Negative List Management” method etc. There are 2 key pillars in this aspect. We request further liberation of the participation of

foreign investment and further application of global standards.

- **Investment** : We request easing of the foreign investment regulation against certain industries. For example, the scope of undertaking construction for foreign-owned construction companies (construction company with 100% foreign investment) to be able to take is limited to construction work by joint venture of Chinese and foreign-owned company with more than 50% foreign investment. Furthermore, in the telecommunication industry, wholly foreign-owned or majority foreign investment companies are not allowed to obtain business licence.

- **Household Electrical Appliances** : The production bases for foreign-owned household electrical appliances manufactures that advanced into the Chinese market early on are dispersed by product, however as the consolidated taxation system is not recognized, it is not possible to make active investment. We request the early introduction of the consolidated taxation system for the purpose of enhancement of competitiveness by integrated management of groups and further development.

### **Main items that have improved from the last year's proposals**

The followings are main items that we have seen improvement out of last year's proposals. We believe we saw the improvement along the lines of the proposals in these items and we thank the Chinese government for the initiatives to improve the business environment. However there are still many fields we would like to see improvement and we hope the bold reform will continue to be implemented.

1) Progress of promotion of paperless in Custom Clearance (The 2015 White Paper,p26, Proposal ⑦)

Full-scale promotion of paperless in Custom application procedures has been enforced across China since April 2014. The operation of paperless is stabilized in all customs and thus it has led to reduction of lead-time related to custom procedures.

2) Easing of reinvestment regulations (p30, Proposal ⑤)

In principle, foreign-owned enterprises were unable to reinvest in China using RMB that was converted from foreign-currency denominated capital, however the regulation was eased in June 2015 and it became approved to reinvest in China using the capital converted to RMB from June 2015 with the "Circular on the Reform of the Administration of the Conversion of Foreign Equity Capital of Foreign Invested Enterprises" (Circular Huifa [2015] No. 19).

### 3) Cleanliness of Power Generation (p112, Proposal ①)

“Full-Scale Implementation Plan for Reform of Ultra-Energy Conservation and Emission Reduction of Coal-Fired Power Generation” in December 2015, and “Guidance Opinion on Renewable Energy Development and Utilization Target System” were published and cleaning of coal-fired power generation and the target ratio of renewable energy except hydroelectric power were presented.

### 4) Improvement on Vehicle Fuel Property (p198, Proposal ①)

As for the vehicle fuel property in the market around big cities, it has significantly improved in both petrol and diesel.

### 5) Easing of Regulations for Foreign Enterprises/Overseas Contents and Removal of Entry Barriers (p220, Proposal ①)

In the Catalogue for the Guidance of foreign Investment Industries, the “Distribution of Audio/Visual Products (excluding movies)” was removed from the 2015 version of the catalogue, thus it helped ease the regulation for foreign enterprises.

### 6) Development of Deregulation of Finance (p254, Proposal ①)

Development was seen in the deregulation of finance as the deposit-loan ratio (ratio of loan against deposit) was lowered to below 75% from October 2015, thus the ratio limit and the upper limit of deposit interest were removed.

## **Japanese companies business Initiatives in China**

Japan's investment in China in 2015 was 3.2 billion USD, which was a drop of 25.9% compared with last year. It has decreased for 3 consecutive years (Fig. 1). With the background of raising labor cost, difficulty in securing labor force, and the changing business environment in China; we believe the recent underlying downward trend has been manifested. Besides Japan, other countries/regions are also showing decline of investment, investment by Taiwan decreased by 14.9%, U.S. by 3%, Germany by 24.6% and Britain by 20%. We believe that the traditional type of investment in China, namely investing as the export base is facing a turning point. Further, even though the investment by Japan has decreased, it is still the No. 1 country that invests in China by country/region for accumulated value of investment excluding Hong Kong and British Virgin Islands.

The survey conducted on Japanese companies in China by JETRO in October – November 2015 (Fig. 2) shows that 38.1% of companies expressed “expansion”, 51.3% expressed “remaining the same” for their direction of business expansion in the next year or two. The intension to expand business in China dramatically reduced compared to 2011 (66.8%→38.1%).

However not all industries expressed the decline of intention to expand. When we see the

ratio of “expansion” by type of industry, the Non-manufacturing industry has higher intension of expansion than the manufacturing industry (Fig. 3, Fig. 4). Furthermore, within the manufacturing industry, “Food (52.4%)”, “Transportation Equipment (43.5%)” and in the Non-manufacturing industry, “Wholesale and Retail (50.9%)” are industries that are specifically domestic-sales orientated, that are showing higher intention of expansion. On the other hand the fiber industry that is an export-orientated business showed less than 20% (19.2%) in the same ratio of intention of expansion.

It can be seen that the superiority of China for export-orientated industries has been declining. On the other hand, domestic-market orientated industries view China as a promising market, and continue to strengthen the development of the China Market. 2015 was the turning point of investment strategy in China by Japanese companies, shifting from export-orientated strategy to a domestic-market orientated strategy. (It is likely the same with European and US companies).

This trend of Japanese companies matches with the movement of China that is aiming to shift from investment-led economy to consumption-led economy. We greatly hope for the progress of reform in each industry to smoothly realize Japanese companies’ investment plans to develop in the consumption industry.

A representative industry for the consumption industry is the logistic industry. It was emphasized to focus on reducing logistic costs for enterprises, and the development of green logistics and cold chain logistics in the 13.5 Plan. As the competition in the market has intensified, from the point of securing competitiveness for enterprises, it is imperative to improve the efficiency of supply chains.

Also green development was cited as one of the 5 development philosophies in the 13.5 Plan. It is also important for maintaining the market that is sustainable and it is imperative to upgrade the regulation for energy conservation and environment protection. Japanese companies would like to contribute in providing solutions to these social issues that China is facing.

### **Japan in the Chinese economy**

Japanese companies have played very important roles for China in expanding the economic scale as China has been trying to enhance the quality and efficiency of the growth. As for trade, Japan came in second as the destination country for exports of China by country with the volume of 135.7 billion USD. In import category, Japan came in the third with the volume of 143 billion USD. Thus Japan is a very important trade partner for China. China imports production goods such as parts and components and capital goods such as machinery to utilize in production in China, then export the products worldwide. Especially

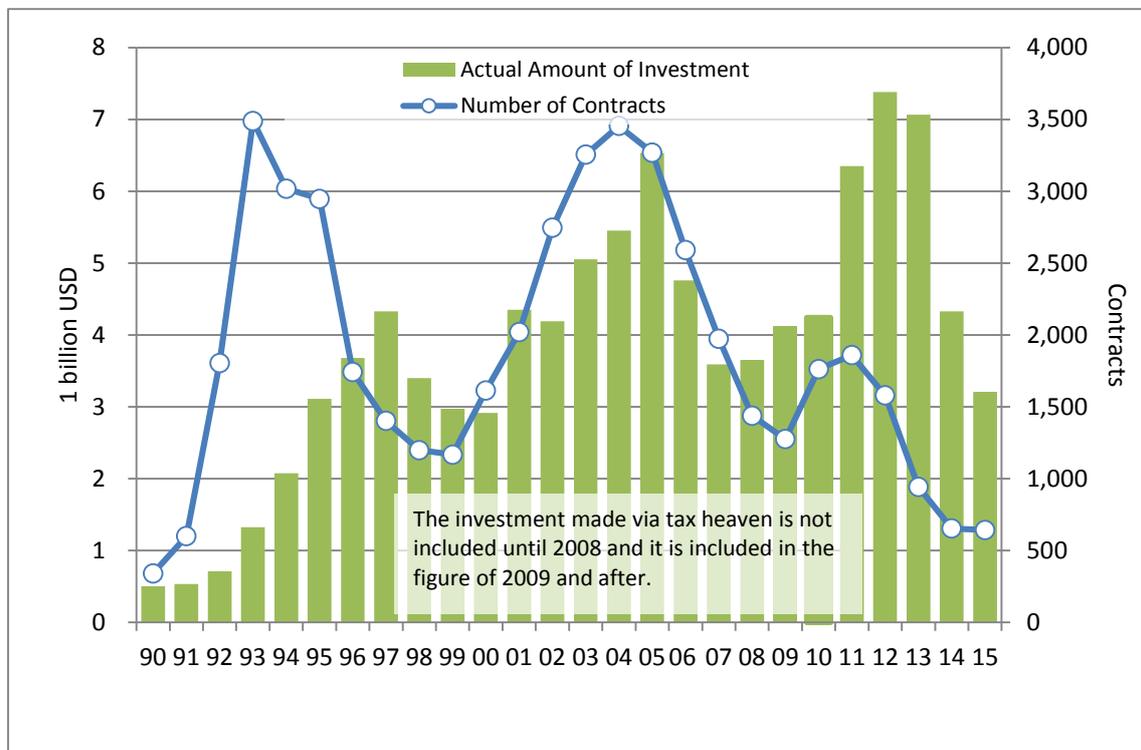
many key parts and machining tools are imported from Japan.

As for investment, Japanese companies top the number of companies present in China by country with the number of Japanese companies that have business in China are 23,094 (as of the end of 2012) that is 7.9% of the whole foreign-owned enterprises. They produce more than 10 million jobs directly/indirectly, thus they contribute in creating jobs. They are also working on improvement of the work environment and enhancement of the welfare system.

Furthermore, many Japanese companies have superior technologies/know-how, thus they are contributing to the improvement of technical capacity and management efficiency of Chinese Companies in both receiving and placing orders and enhancement of competitiveness. Moreover, the presence of Japanese companies is high in the supply chain of some industries since the supply of some key parts and special raw materials in high-tech product that cannot be substituted by others.

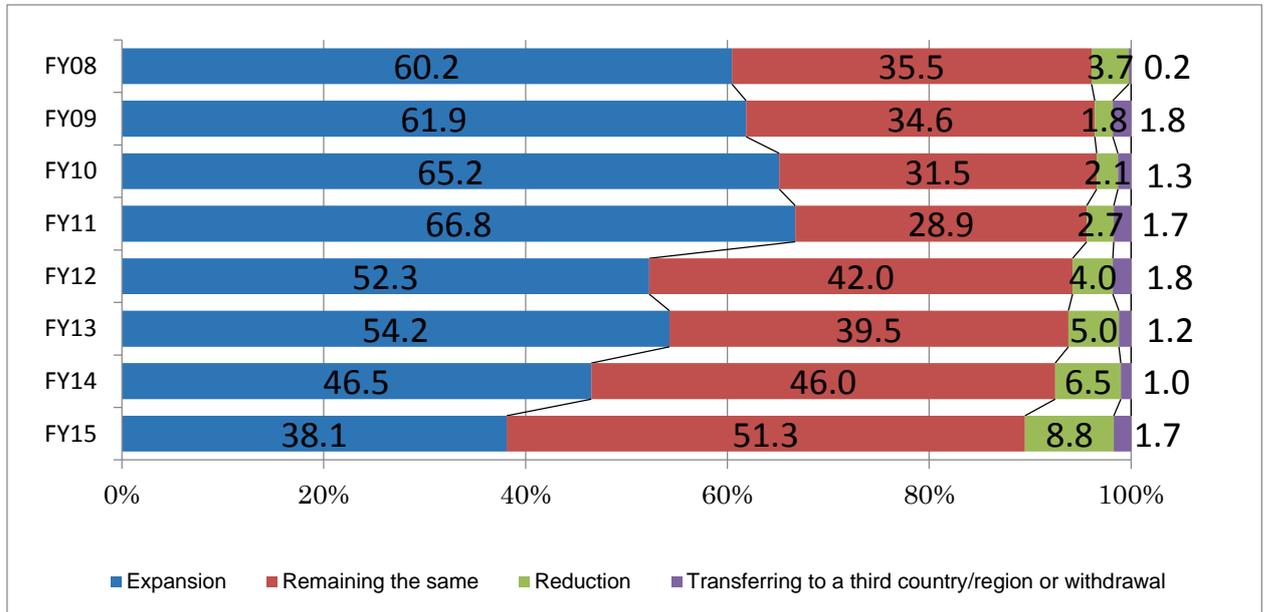
As the economy is globalized and supply chains are complexly intertwined, Japanese companies are trying to continue to grow together with Chia.

Fig. 1 : Japanese Investment in China



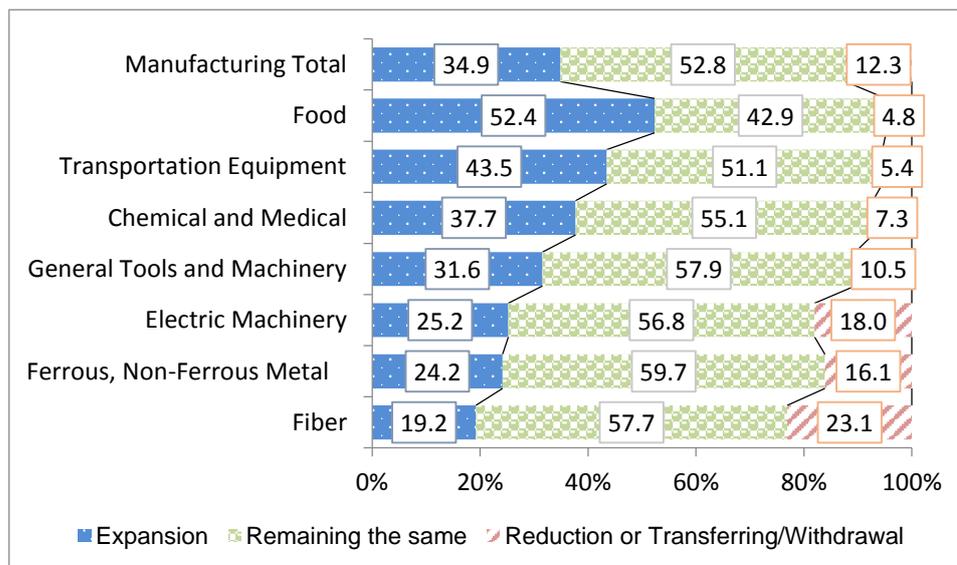
Source : Ministry of Commerce and CEIC

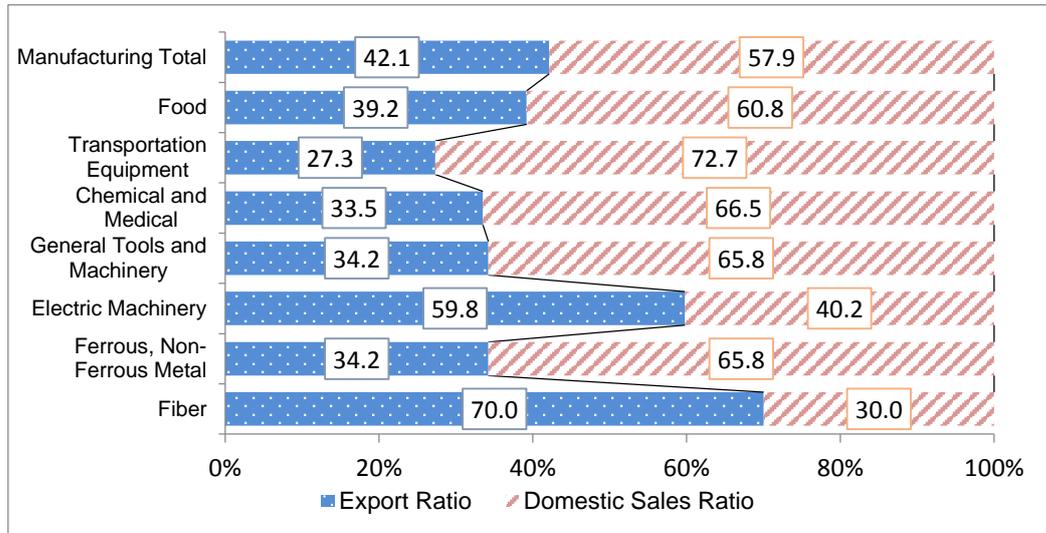
Fig. 2 : Direction of Business Expansion in the Next Year or Two



Source : “Survey on Business Conditions of Japanese Companies in Asia and Oceania,”  
JETRO

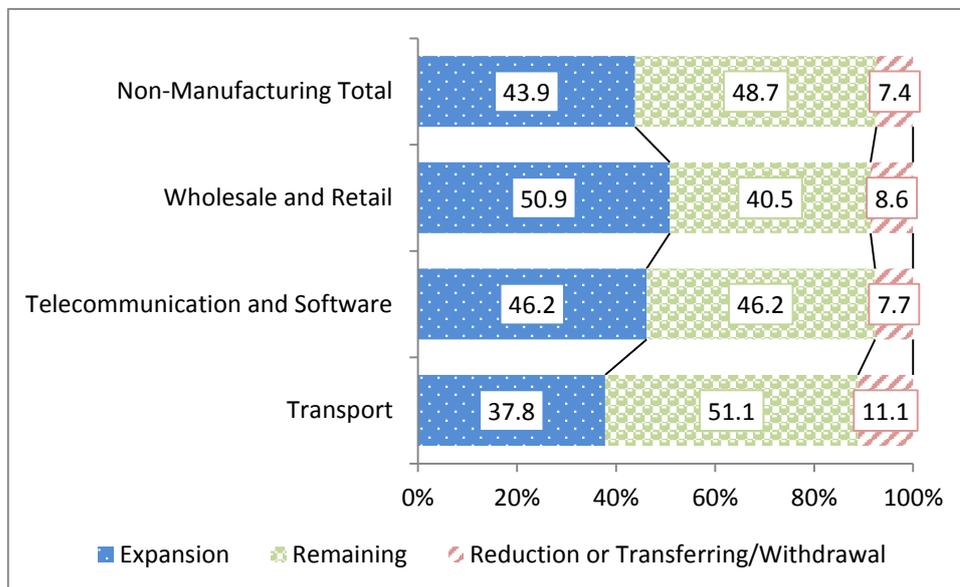
Fig. 3 : The direction of future business development and export/domestic sales ratio in Manufacturing Industry (FY 2015)

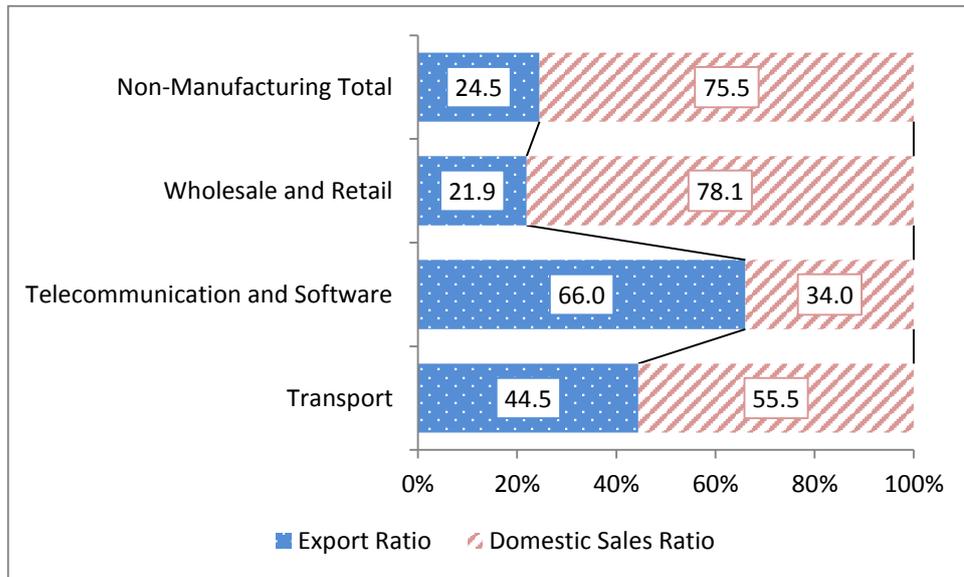




Source : "Survey on Business Conditions of Japanese Companies in Asia and Oceania," JETRO

Fig. 4 : The direction of future business development and export/domestic sales ratio in Non-Manufacturing Industry (FY 2015)





Source : "Survey on Survey on Business Conditions of Japanese Companies in Asia and Oceania," JETRO