

Executive Summary

Direction of Chinese Economic Reform and Main Proposals

Hope for further deepening of reform

In the 13th 5-year Plan (hereinafter referred to as the 13.5 Plan), in order to achieve the full-scale completion of a moderately prosperous society, the government 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.

In the Government Work Report of the 5th meeting of the 12th National People's Congress held in March 2017 (hereinafter referred to as the "Government Work Report"), as the priority work mission in 2017, the government will "address overcapacity, reduce inventory, deleverage, lower costs, and bolster areas of weakness" to deeply push forward the process. In addition, it is pointed out as issues to be solved that some reform measures and policies are not thoroughly implemented, such as issues with a large collection of various fees from companies and the existence of cases lacking standards/fairness/rational thinking in administrative law enforcement. Furthermore, based on this recognition, intensifying reforms and enhancing policies will reduce corporate transaction costs caused by the system and lower other costs such as logistics.

Among other priority work missions, the government "will intensify the reform of important fields and key areas" and in order to fulfill a decisive role of the market in resource allocation and at the same time to effectively manifest the function of the government, it will also intensify the reform of "simplification of administration and delegation of authority", "combination of mitigation and management" and "optimization of services".

Japanese companies hope that 2017 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 improve the modern market system, to deepen the reform of the administrative system and to improve the new system for opening up. 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 proposes reviewing various systems that are obstructing fair competition in line with the market economy to adequately leverage the market principles.

- **Investment:** As the market economy progresses, it is a natural trend and unavoidable for companies to be restructured by revitalizing competition, therefore, we propose improving system to reduce the time and cost burden on business restructuring including withdrawal to alleviate. Especially, the tax related burden is significant. For example, it is necessary to shorten the time taken for deletion of tax registration. With these measures, it is expected that predictability will be improved, and it will attract new investments, and lead to optimization of China's industrial structure.

- **Taxation/Accounting:** With regard to tax relief procedures and appeal system, the tax reexamination proposal will be applied after tax has been paid in advance and then appealed to the upper level tax bureau 1 administrative level higher than the corresponding tax bureau. However, in reality the reexamination system is not fully functioning, hence we would like to request further system improvement. We would like to request the State Administration of Taxation for reexamination request and the establishment of Tax Courts.

- **Labor:** Expatriates etc. who are working in China are in a situation where they have to pay social insurance premiums in duplicate in Japan and China, which is a heavy burden for Japanese companies. By means of the early conclusion of the Japan-China Social Security Agreement, it is possible to resolve issues such as double payment of social insurance premiums. So we propose raising the frequency and accelerate the negotiation of the Japan-China Social Security Agreement so as to reduce the burden on Japanese companies and expatriates etc.

- **Logistics:** Although the standard of customs clearance and quarantine system is being upgraded, there are still some parts that have not kept pace with the expansion of regional customs integration. There are differences in system level and settings depending on the region, as well as frequent delays caused by system failure itself, thus hindering the filing procedures. We propose improving the system, with consideration to efficiency, stability and versatility.

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

addition, in the Government Work Report, it is necessary to urge to improve the property rights protection system, to guarantee various property rights owned by economic organizations and individual citizens based on the law, to encourage people to build wealth by entrepreneurship and innovation, to arouse and protect entrepreneur spirit, to create an environment for entrepreneurs to be able to endeavor business and invest with peace of mind; establishing a strict policy that cracks down on acts that infringe corporate property rights. As for intellectual property issues, there are still strong calls from Japanese companies for improvement, we request appropriate measures for various policies and measures to suppress acts of counterfeiting etc.

- **Protection of Intellectual Property:** The employee invention system is defined in a comprehensive manner under the Patent Law and the Law for implementing the Law in the first place. Expanding the scope of application to new rights such as new plant variety rights and other rights such as integrated circuit placement rights without superseding rules like the Patent Law may cause confusion in the legal system. Hence it is not necessary to establish the employee invention regulations. Furthermore, even if it is enacted, in view of the above, we request that the subjects of this regulation be exclusively to patent and to thoroughly implement the “agreement priority principle” agreed between the business entity and the inventor.

- **Protection of Intellectual Property:** In order to unify actions that fall under repeated offences, sharing of punitive information for seizure by the Industry and Commerce Administration Bureau, the Quality and Technical Supervision Bureau, the Intellectual Property Bureau, Customs and public security institutions including both the central and regional office. Furthermore, in order to prevent repeated offenses, we request further facilitation of criminal transfers between administrative agencies and public security institutions and to closely cooperate with right holders, by providing information owned by the custom etc. We also request to appropriately proceed with the legal management of severe punishment against repeated offences and the implementation of these efforts on a nationwide scale.

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. In 2016, the government withdrew a total of 165 items from administrative examination and approval items that the provincial governments were implementing under the administrative examination and approval items of each department of the State Council and the designation of the State Council, as well as implementing initiatives such as organizing and standardizing 192 examination and approval intermediary service items.

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:** For the advance ruling system of the HS number, we request improvement from the application of only the customs office of the application destination to a system that can be used uniformly nationwide. We also request improvement of the system so that the customs authorities can speed up the response when using this system and make inquiries to the direct customs by an easier method such as email. At the same time, we propose releasing documents that interpret the items subject to HS numbers in details. We also propose unifying necessary documents, time required at the time of permission related to entering to port, docking and loading as much as possible.

- **Technical standard/certification:** In some standards, it is seen there are unrealistic setting of test conditions or high numerical setting of target values and ideal values. We request to avoid developing excessive specifications and excessively detailed standards. We also request that simplification be promoted by consolidation and elimination of standards. Standards that do not consider technical level or social situation can hinder technological progress and free competition and do not conform to the direction of China's policies to promote innovation.

- **Chemicals:** Hazardous criteria for chemicals differ among administrative departments, and China MSA, IMDG, the Bureau of Quality Inspection and Quarantine and Customs generally judge according to the hazardous chemical inventory. As a result, the place of customs clearance and storage were divided due to the difference in the judgment result between China MSA and the Bureau of Quality Inspection and Quarantine/Customs, and the hazardous chemicals have to be moved over and over again many times. Thus increasing further risks. Therefore, we request the unified adoption of criteria based on the concept of hazardous & dangerous goods in the administrative departments that manage and supervise chemicals in harbors.

- **Banking:** In addition to regulations concerning foreign exchange transfers, external remittances, etc. , guidance and management are also recognized to be reinforced. If this situation becomes prolonged, there is a possibility that negative impacts, such as obstacles to fund management based on customers' actual demand, may become obvious. It is also highly likely that it will be a concern for foreign companies entering China. Furthermore, enhancing the degree of freedom and transparency of exchange transactions and cross-border transaction is essential for promoting the internationalization of the RMB. For these reasons, we propose easing and optimization of regulations, guidance and management concerning this matter.

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. Also in the Government Work Report, it indicated that it would revise the “Foreign Investment Industry Guidance Inventory”, to further ease the entry conditions for foreign capital in the manufacturing and service industries, etc., to further strengthen the conditions for entry of foreign capital, and to treat domestic companies and foreign-affiliated enterprises equally in terms of qualification permission, standardization, government procurement, and policy application of “Made in China 2025” etc. thus China’s initiatives to become a more open market are progressing. 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 propose easing of the foreign investment regulation against certain industries. For example, in a car production enterprise, foreign capital companies cannot invest more than 50%. Even with an investment ratio of 50% or less, it is necessary to obtain permission from related government agencies such as the National Development and Reform Commission, the Ministry of Industrial and Information Technology, and the Ministry of Commerce against changes in the contribution ratio. As a result, it is impossible to grasp the real control right of a joint venture company, and changes in the investment ratio within 50 % are often conditioned by relevant authorities, thus it has made it possible for the State to exercise its influence on the direction of business of individual companies. The “China Automobile Medium- to Long-term Development Plan” indicated that its direction is to gradually ease restrictions on ownership of joint ventures. We request that specific measures will be clarified.

- **Taxation/Accounting:** Currently, while the transition to IFRS(International Accounting Standards) is being considered internationally, from a viewpoint of responding to consolidated financial results, we request flexible application of the Chinese corporate accounting system where not only the current December settlement of accounts in China but also companies can set the fiscal period by themselves.

- **Technical Standards/Certification:** In the public standard formulation process such as national standards, or industry standards, etc., the operation method is not unified and lacks transparency, for example, the membership fee and membership expenses etc., are still differentiated by domestic and foreign-capital. We propose increasing transparency and impartiality by facilitating the participation of foreign-affiliated enterprises such as making the process of formulation and revision related to standardization activities open to the public in principle, and making conditions to participate in the standardization technical committee and standardization formulation work group etc. the same for foreign enterprises as Chinese enterprises.

- **Information and Communication:** Cloud computing and data centers etc., are the core of ICT

business in the future, and foreign-affiliated enterprises can exercise their uniqueness and identity further. We request deregulation for the cloud service business so that foreign-affiliated companies will be able to provide the service.

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)-Simplification of establishment of foreign-affiliated enterprises and modification procedure (2016 White Paper, p32、 Proposal ①)

If it does not fall under the field of special control measures for foreign investment entry regulated by the government, the establishment and modification of foreign affiliated enterprises can be done only by submitting related materials by designated online system based on the "Interim measures on Notification Management of Foreign Investment Enterprise Establishment and Modification" enacted by the Ministry of Commerce on 8th of October 2016.

2)-Promotion of mutual understanding with relevant authorities (2016 Waite Paper p132、 Proposal IV)

By carrying out exchanges of experts between the Japan Chemical Industry Association and the State Administration of Work safety and the Environment Protection Division, it promoted mutual understanding on chemical laws and regulations of both Japan and China.

3)-Opening up Chinese Citizens Outbound Travel Operation of the Wholly Foreign-investment Travel Agency (2016 White Paper, p258, Proposal ①)

- In Article 23 of the "Travel Agency Regulations", a foreign investment travel agency is not supposed to deal with the outbound sightseeing travel business of the Chinese citizens and the sightseeing travel business to Hong Kong, Macao, and Taiwan. However, in July 2016, the State Council suspended this tentatively in the Free Trade Area and admitted Chinese outbound sightseeing travel business (excluding Taiwan) to foreign investment travel agencies that satisfied the conditions.

Japanese Companies Business Initiatives in China

Japan's investment in China in 2016 was 3.1 billion USD, which was a drop of 3.1% compared with

last year. It has decreased for 4 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. Furthermore, looking at the amount of investment to China from the rest of the world in 2016, it decreased by 0.2% (USD base), and it began to decline for the first time since 2012. By industry, the manufacturing industry is down 10.2% to 2-digit declines, and the non-manufacturing industries maintained positive growth of 4.2%, owing to favorable conditions such as leasing and commercial services, wholesale and retailing, Information and communication and computer services.

The survey conducted on Japanese companies in China by JETRO in September 2016 (Fig. 2) shows that 40.1% of companies expressed “expansion”, 52.8% expressed “remaining the same” for their direction of business expansion in the next year or two. The intension to expand business in China increased by 2.0 points from the previous year, although it dramatically reduced compared to 2011 (66.8%→40.1%).

However not all industries expressed the decline of intention to expand, but there are variations depending on the type of industry etc. 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 (53.6%)”, “Transportation Equipment (43.0%)” and in the Non-manufacturing industry, “Wholesale/Retail (54.7%)” 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% (19.1%) 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.

Although the value of investment in China from the world has declined, in order to increase investment in China, it is beneficial to smoothly realize the investment intentions of Japanese domestic sales type companies to develop consumption field, since it synthesizes with China’s move towards a shift from an investment-led to a consumption-led economy. To that end, improvement and establishment of the investment environment are indispensable. In the 13.5 Plan, it highlighted to improve the standard of openness to the international community, and cooperation with other countries in strategic mutual trust, cooperation in investment, economic and trade etc. Furthermore, in the Government Work Report, it mentioned that the government would be active and play a leading role in opening-up to the international community. It is expected that easing conditions for further entry for foreign capital, simplifying procedures in the labor field such as employment of foreigners and adoption of global standards in the tax field. Such promotion of opening up to the international community at a higher level realizes mutual complementation with each other’s strengths, and at the same time, it is imperative to intensify the win-win relationship in increasing

investment in China and the smooth realization of the consumption field of Japanese companies

Furthermore, in order to further develop the consumer market, it is necessary to reduce the distribution cost. For that purpose, we believe that further development of human, physical and institutional infrastructure regarding custom clearance, distribution, transportation, etc. will be important. In the 13.5 Plan, it was highlighted to lower the logistics cost of enterprises, to work on the development of green logistics and cold chain logistics etc. In addition, in the Government Work Report, the reduction of distribution cost was cited as an issue, and it was included in the priority work mission. Since logistics is a fundamental industry involved in many industrial sectors we believe that the effect of cost reduction, such as integration of customs clearance and simplification of various procedures, will affect a wide range of fields.

Japanese companies would like to continue to make contributions in these issues.

Japan in the Chinese Economy

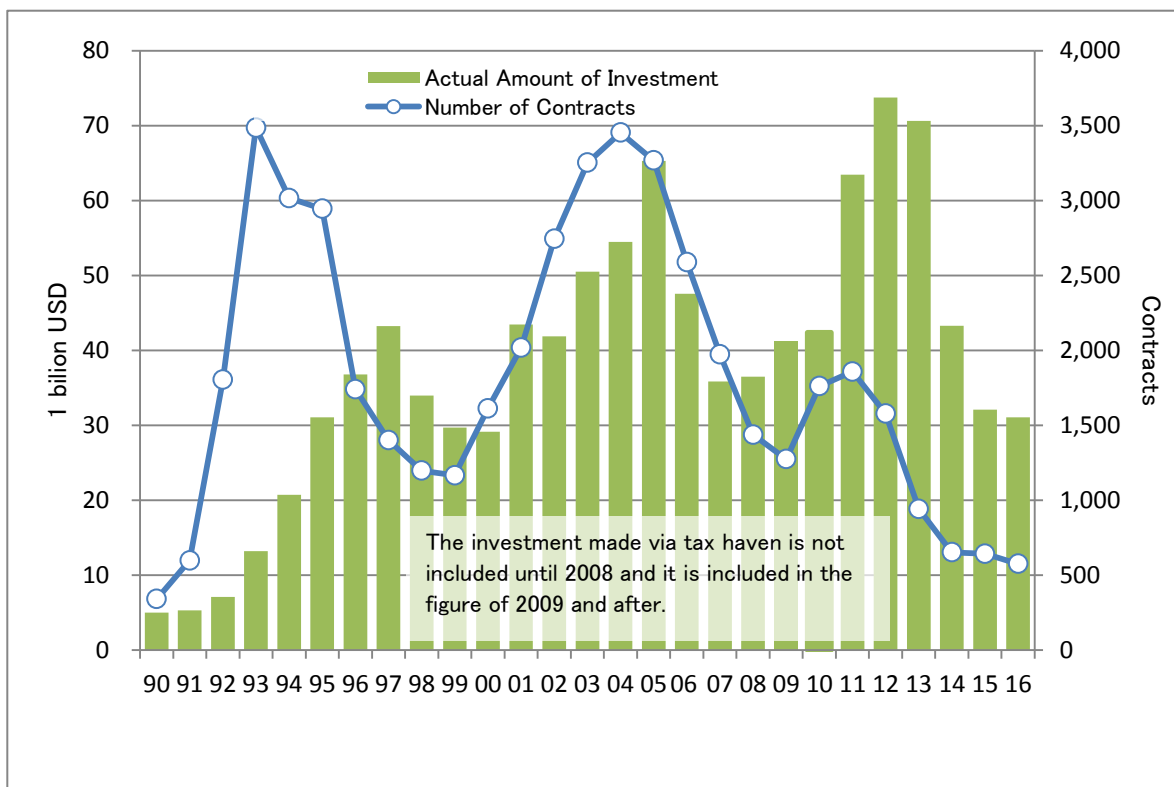
Japanese companies have played very important roles for China in expanding the economic scale as China has been trying to enhance the quality and efficiency of the growth. As for trade, Japan came in second in 2016 as the destination country for exports of China by country with the volume of 129.2 billion USD. In import category, Japan came in the second with the volume of 145.6 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.

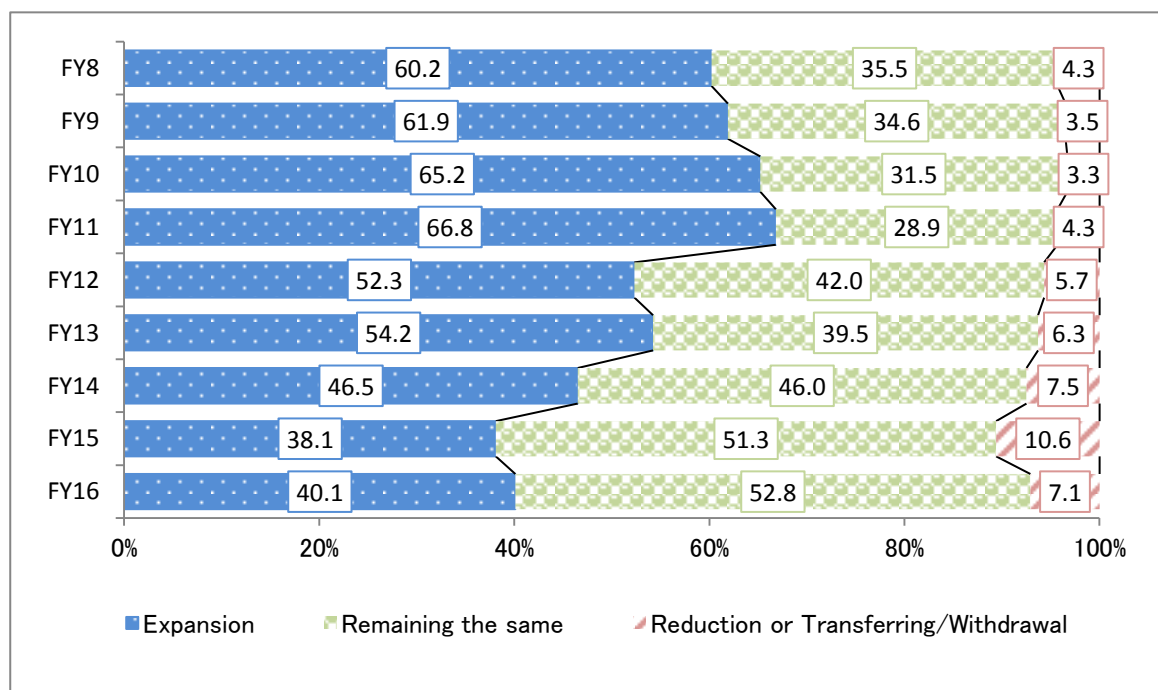
As the economy is globalized and supply chains are complexly intertwined, Japanese companies are trying to continue to grow together with China.

Figure 1: Japanese investment in China



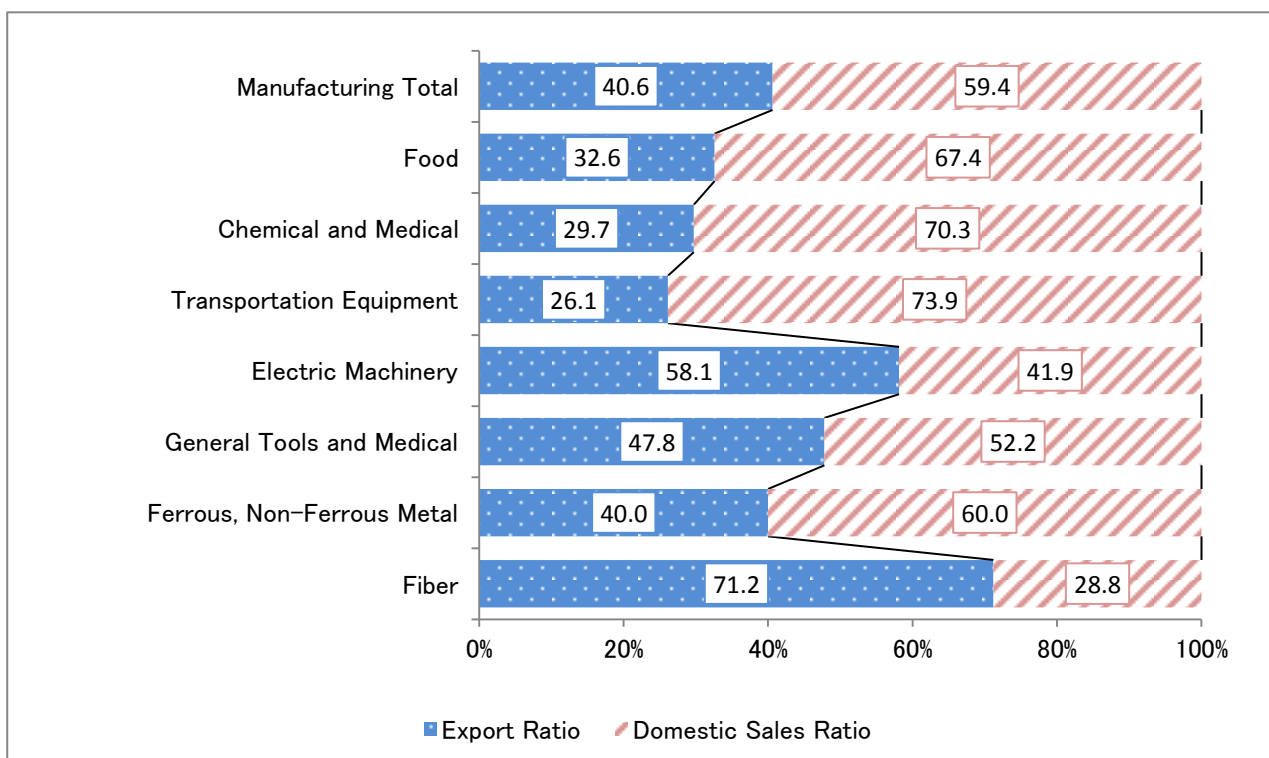
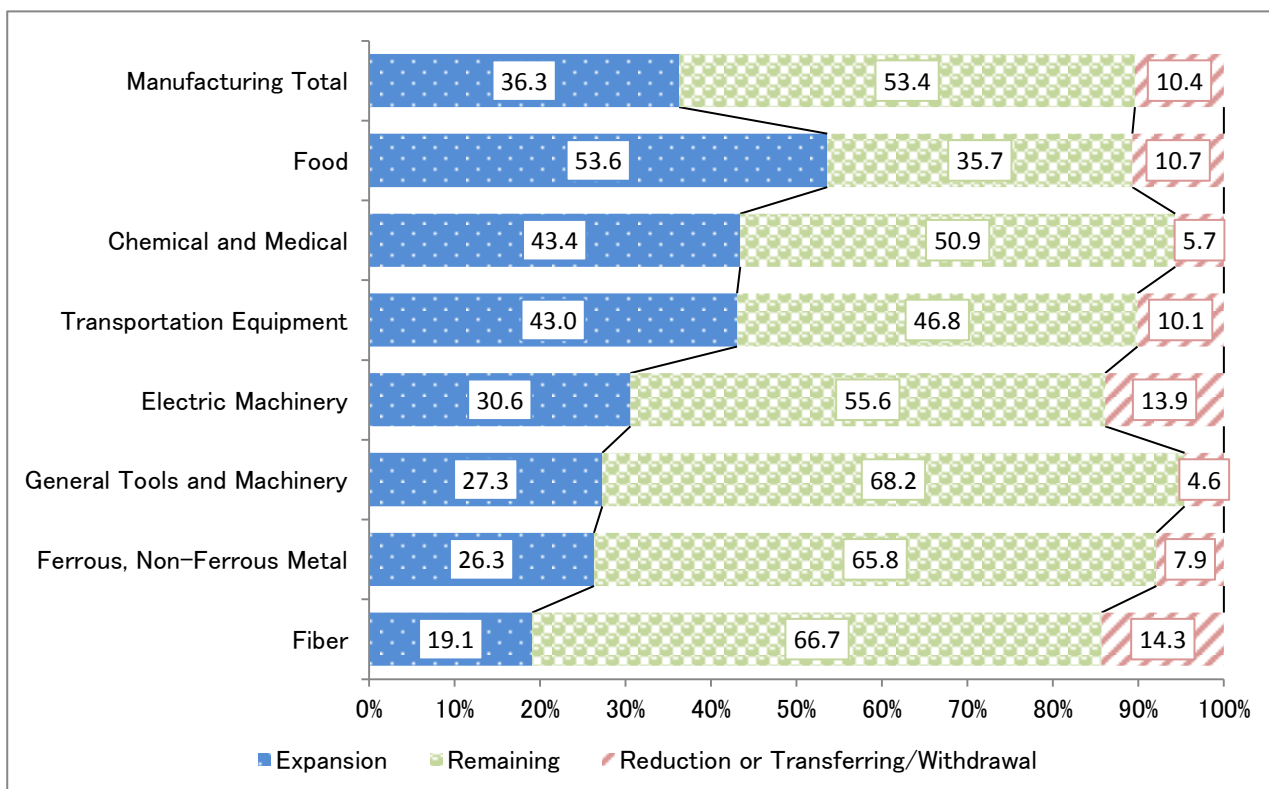
Source: Ministry of Commerce, CEIC

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



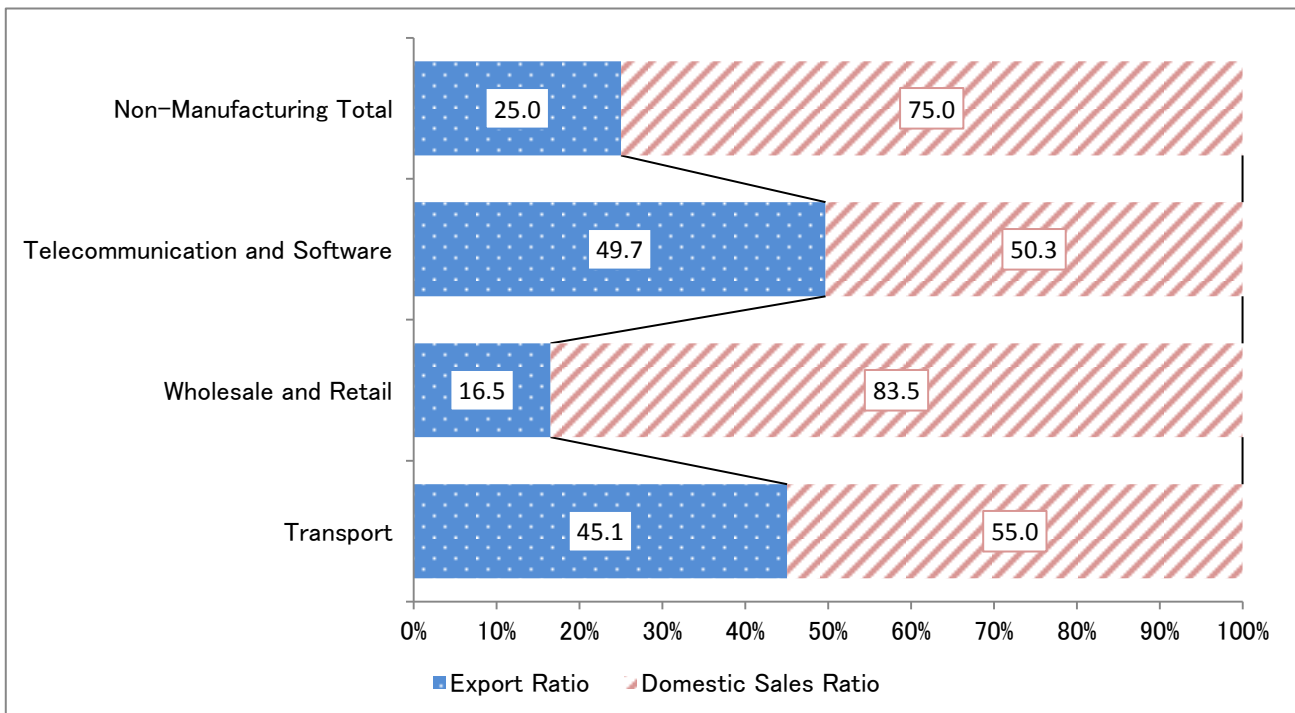
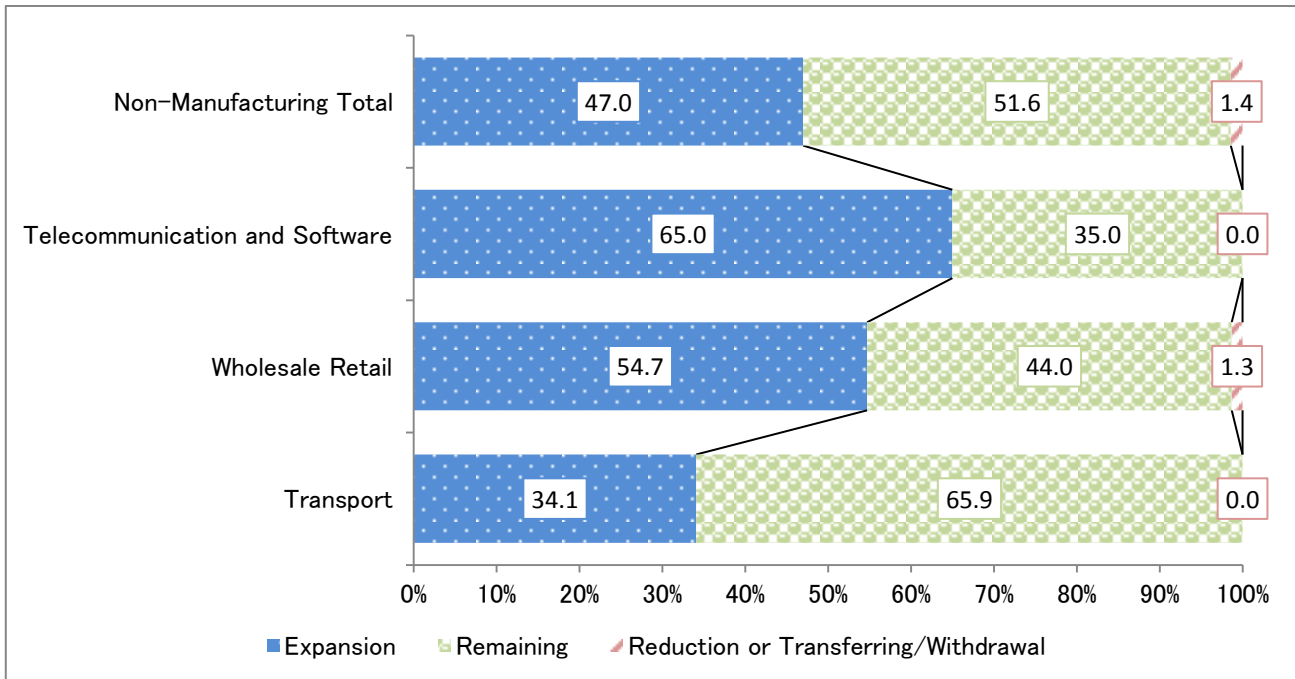
Source: JETRO “Survey on Business Conditions of Japanese Companies in Asia and Oceania”

Figure 3: The direction of future business development and export/domestic sales ratio in Manufacturing Industry (FY 2016)



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

Figure 4: The direction of future business development and export/domestic sales ratio in Non-Manufacturing Industry (FY 2016)



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