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Direction of Chinese Economic Reform and Main Proposals

Expectation for Further Deepening of Reform

In the Outline of the 13th Five-Year Plan for the National Economic and Social Development (hereinafter referred to as the 13-5 Plan), it states that in order to achieve a full-scale completion of a moderately prosperous society, the government will deal with the firm establishment and thorough realization of 5 growth philosophies, namely, innovation development, harmonious development, green development, open development and development that can be enjoyed by all. To this end, it again highlights the promotion of structural adjustments through the reform and the policy that emphasizes the importance of the role of market in the 13-5 Plan.

In the government activity report (hereinafter referred to as the Government Activity Report) reviewed in the 2nd meeting of the 13th National People's Congress (NPC), based on the achievement status of the 13-5 Plan, the priority activity missions in 2019 were established. At the head of the mission, it was cited "to continue to reform and improve macro control and keep the economic movement within a reasonable area (range)", and it also stated that by using the fiscal, financial and employment policies to demonstrate the function of macro policy conversion period (function to mitigate periodic economic fluctuations). In addition, employment priority policy was positioned as macro policy for the first time. Furthermore, it put more emphasis on further promoting reform and opening up, accelerating the establishment of a unified and open modern market system with competition and order, easing the condition for market entry, strengthening fair supervision and management, establishing a legalized, internationalized and streamlined business environment in place to further vitalizes various market players.

Moreover, on the 15th of March 2019, during the NPC, the Foreign Investment Law, which is the basic law for foreign companies, was passed and enacted (enforced from the 1 of January 2020). Under this Law, the contents that Japanese companies etc. have requested until now in the "Chinese Economy and Japanese companies White Paper" were included as the following: It is necessary to hear the opinions and proposals of foreign companies when establishing laws and regulations relating to foreign investment (Article 10); equal participation of foreign companies in standardization work (Article 15); ensuring fair participation of foreign-invested enterprises in government procurement activities (Article 16); and It is possible to freely deposit and remit RMB or foreign currency from overseas according to the law with regard to the interests of foreign investors and return on capital etc. The Law will have a major impact on Japanese companies operating businesses with China, and we hope that the law will be implemented as specified in the provisions stipulated by the law so that the Chinese market can further open up.

Japanese companies are hoping that the year 2019 will be an important year for deepening the reform that will lead to the development of a "Highly Transparent" business environment, in which "Non-Discriminatory Status is secured" while they are poised to actively contribute through various businesses as the Chinese government is planning to deepen reforms and thoroughly implement the 5 development philosophies.

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In the 13-5 Plan and the Government Activity Report in 2019 based on it, the Chinese government is in the direction to deepen the reform by completing the modern market system, deepening the reform of the administrative management system, improving the new system for overall opening up. Meanwhile, the issues faced by Japanese companies in the Chinese business field are summarized in each category as follows.

In deepening reforms, we are convinced that many of the constructive ideas are included in this White Paper, which has compiled proposals for analysis and resolution of the issues facing Japanese companies engaging in business in China for a long period of time. We would like to see that something in this White Paper is used as a reference for policy management in the future.

Improving the Modern Market System

In the 13-5 Plan, it was included that various regulations and methods that are obstacles to unified market and fair competition will be thoroughly organized and removed, and a review system that allows fair competition will be implemented. It also highlighted that market entry restrictions will be relaxed. In this White Paper, various systems that are obstacles to fair competition will be reviewed in order to fully utilize market principles in line with this direction and we also propose development of highly transparent market economy rules and its proper operation.

- **Investment:** It is a natural flow for companies to be forced to restructure business through the revitalization of competition while the market economy is progressing; hence we hope that the system can be established to reduce the burdens such as time and cost involved in business restructuring such as withdrawal, division and merger etc. In particular, the tax burden is heavy, for example, there is a need to shorten the time required to cancel the tax registration. These measures are expected to improve predictability, and in turn lead to new investments and the optimization of China's industrial structure.

- **Competition Law:** From the viewpoint of improving transparency of examination on concentration of undertakings, we propose clarifying provisions on the basis of whether or not to approve and the basis of conditional approval, the criteria of examination on concentration of undertakings such as the method of defining the market range, and in particular the criteria for granting and revoking the restriction condition of "maintaining independence of operations or assets", and reviewing concentration of undertakings purely from the perspective of the effects of restricting competition.

- **Software:** In order to improve the level of software personnel, there are many cases in which Chinese employees are dispatched to the headquarters etc. in Japan for over a year. The personal income tax for Chinese employees dispatched to Japan, which should be reimbursed, may not be reimbursed and results in double taxation. We propose for the reliable implementation of the tax treaty between Japan and China.

Deepening the Reform of the Administrative Management System

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It was highlighted that the administrative review and approval system reform will be deepened, and the scope of review and approval items will be reduced to the maximum possible extent by reducing interference to corporate management by the government as much as possible, and to realize open, transparent, highly effective, speedy and fair government service for everyone in the 13-5 Plan. Also in the Government Activity Report, it emphasized smooth investment and business performance by streamlining examination and authorization and optimizing services, and minimizing examination and authorization items as much as possible and cutting down procedures and steps with regard to items for which examination and authorization are essential. The simplification and acceleration of administrative procedures, abolition of authorization and certification excluding the minimum necessary, and improvement of government services are still required by Japanese companies in many fields in this White Paper. As the Chinese government is planning to deepen reforms including “simplification of administration and authority transfer”, “combining relief and management” and “optimization of services” in 2019, we propose more intense efforts to develop.

Furthermore, major amendments of taxation have been made, such as the reduction of the value-added tax rate from the 1st of April 2019, and the reduction of the social insurance burden rate for companies from the 1st of May 2019. Further improvements related to improving business foreseeability, such as securing a sufficient preparation period for such system change and unification of system application and interpretation, are required in many fields.

- **Taxation:** The tax law has continued to be reviewed, with the result that the value-added tax rate was reduced in fiscal year 2018 and the value-added tax rate was further reduced since the 1st of April 2019. With further revision of the tax law, the tax reduction effect is expected. On the other hand, in last year’s amendment, there were cases where it was treated as a filing error due to the difference of the practical interpretation from the trading partner area, and some companies struggled to respond to the tax law amendment. In the future, prior to the amendment of the tax law, we hope for measures that take into consideration of tax payment practices of companies, such as securing preparation time in advance and indicating the guidelines that give concrete examples of tax payment and filing tax returns.

- **Energy Saving and Environment:** Penalties against companies that are in violation of laws and regulations are being made more severe with revisions of the Environment Protection Act etc. In order to ensure that Japanese companies properly comply with laws and regulations, we propose that the enforcement of laws and regulations such as monitoring and control by the Ministry of Ecology and Environment, the Ministry of Emergency Management, local government authorities, etc., are not based on arbitrary responses from the person in charge but on the basis of unified standards regardless of whether it's foreign companies or not. In addition, we also propose that when administrative guidance and the like are given to an enterprise, the explanation should be presented in writing on the grounds for violation of laws and regulations and data etc. The Ministry of Ecology and Environment has announced that it is strictly prohibited to take a measure that is “One size fits all (measures that do not consider individual circumstances)”. However, environmental audits are carried out suddenly for companies located

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in areas such as the Fenhe and the Weihe Plain and there are cases in which the factories have lost their credibility due to a temporary closure or business suspension order. Furthermore, we propose establishment of fair and reasonable rules, such as publication of objective criteria when selecting companies targeted for business suspension and thorough prior notification, hence avoiding suddenly ordering business suspension to random factories when local air pollution concentration has risen temporarily or there is a possibility that it will rise.

Improving the New System for Overall Opening Up

In the 13-5 Plan, it presented the full implementation of the market environment in which fair competition takes place, the realization of fair and transparent legal management, the opening up of the service industry and innovation. In July 2018, the “Foreign Investment Entry Negative List (2018 version)” was issued. The restrictions and prohibitions decreased from 63 items to 48 items compared to the previous “The Catalogue for the Guidance of Foreign Investment Industries (revised in 2017)”. Efforts are underway to make China a more open market, with the restrictions on foreign investments ratio being relaxed and abolished in industries such as the banking and automobile industry. In the Government Activity Report of 2019, one of the priority activities was “promoting full openness and nurturing new advantages in international economic cooperation and competition”.

Moreover, on the 15th of March 2019, the Foreign Investment Law, which is the basic law for foreign companies, was approved and enacted at the 2nd meeting of the 13th National People’s Congress (NPC) (enforced from the 1st of January 2020). It is expected that the formulation of implementation details and the amendments of related regulations will be implemented in the future. We continue to propose further abolition of regulation against the market entry for foreign investment and active efforts to further adopt global standards.

- **Investment:** As various negative lists are revised and companies seek to enter new fields, although it is not restricted in the “Special Administrative Measures for Foreign Investment Access (Negative List) (2018 version)” or the “Market Entry Negative List (2018 version)”, there are cases in which other relevant laws and regulations may effectively limit foreign capital to enter fields that are officially open to them to enter. In order to respond to such cases, we propose that the National Development and Reform Commission and Ministry of Commerce set up a response window to understand the issues and maintain the system so that the necessary laws and regulations can be revised through cooperation with relevant authorities.

- **Technical Standards and Certifications:** Cyberspace Administration of China explained that the details of China Internet Security Law would become clear by the regulations, bylaws, standards etc. However, it has not been enacted yet, except for some items. We hope for the establishment and application of a system to prevent foreign products from being treated differently by taking into account the opinions of related parties including foreign companies in the process of establishing these bylaws, standards etc. With regard to regulations in the Internet Security Law, we propose that the system design and application of the system be considered so as not to impede the development of new businesses such as cloud services and to prevent foreign

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companies from being unfairly discriminated in these areas.

- **Cosmetics:** We strongly propose that China shall incorporate the proposals of this White Paper and the proposals of countries around the world in the “Regulations on Supervision and Administration of Cosmetics”, which became a WTO/TBT notification on the 18th of December 2018, and smoothly implement the detailed regulations with a sufficient transition period.

- **Insurance:** Foreign-invested joint venture life insurance companies were not able to file applications for the establishment of multiple branches at the same time. However, as the further opening up of the regulatory field for foreign investment entry is progressing, there are no clearly defined regulations stating that foreign-invested joint venture life insurance companies shall receive the same treatment as Chinese companies, especially in the process of applying for the establishment of new branch offices. We propose that the same provision be made.

Main Items that showed improvement from the Proposals of 2018 White Paper

The main items that showed improvement from the proposals of 2018 White Paper are as follows.

In these items, we believe that improvements have been made along the direction of the proposals, and we appreciate the Chinese government for the efforts to improve the business environment. However, some of these still require some improvement. In addition, there are still many other areas where improvement is expected and we hope that improvement efforts will be continued.

1) Decrease in restrictions and prohibition clauses in foreign investment (2018 edition of White Paper, p.38 “Investment” Proposals ⑧,⑨)

The “Foreign Investment Entry Negative List (2018 version), which came into effect in July 2018, has its restrictions and prohibitions reduced from 68 items to 48 items compared to the Catalogue for the Guidance of Foreign Investment Industries in 2017, and certain easing measures have continued to progress. Progress has also been made in deregulation of certain industries, such as the announcement of deregulation of restrictions on foreign investment ratios in the finance and automobile industries.

2) Reduction of social insurance rate (2018 edition of White Paper, p.58, “Labor” proposal ⑤)

On 5th of March 2019, in the Government Activity Report of the NPC, the insurance rate (corporate share) of Basic Pension Insurance for Urban Workers was reduced and it was decided that each local government could reduce it to 16%. It was also announced that the policy to gradually reduce the rate of Unemployment Insurance and Workers’ Accident Compensation Insurance continues to be implemented. Moreover, at the press conference on 15th of March after the closing of the NPC, Prime Minister Li Keqiang announced that the above-mentioned social insurance burden rate for companies will be reduced from the 1st of May 2019.

3) Revision of technology license related system (2018 edition of White Paper, p.72, “Intellectual Property Right”)

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It is welcomed that the Regulations on Technology Import and Export Administration was amended in March 2019 and the clauses such as the licensor bears responsibility when technology imported to China violates the rights of others (Old Article 24, Paragraph 3), improved technology after transfer belongs to the improved side (Old Article 27), prohibiting restrictive clauses in import contracts (Old Article 29) were removed. We hope that efforts towards the improvement of technology-trading environment will continue in the future.

- 4) Lifting an import ban on rice produced in Niigata (2018 edition of White Paper, p.108, “Agriculture, Forestry and Fisheries industry and Food” Proposal ⑨)

Due to the Fukushima nuclear power plant accident following the Great East Japan Earthquake in March 2011, import restrictions have been imposed on a large number of food items from 10 prefectures. No. 175 public notice of the year 2018 of General Administration of Customs of China was announced on 28th of November 2018, which approved the import of rice produced in Niigata Prefecture and took one step forward to easing restrictions. In order to further enrich the diet of Chinese consumers, we propose continuing to expedite investigations based on scientific evidence for other items such as alcoholic beverages with generally low risk and realizing early deregulation.

- 5) Nationwide implementation of a filing registration system for imported non-special purpose cosmetics (2018 edition of White Paper, p.170, “Cosmetics” proposal ⑥)

On the 9th of November 2018, “Announcement on the Nationwide Implementation of Filing Management for Imported Non-Special Purpose Cosmetics” was promulgated from the National Medical Products Administration (NMPA) and it took effect the next day (10th). Although there are still parts that need improvement since it was implemented on the same day, the filing system at the time of import of non-special purpose cosmetics, which was possible only within the free trade test zone in the past, became possible to implement nationwide.

Initiatives for Chinese Business by Japanese Companies

Japan’s investment in China in 2018 was 3.81 billion USD, an increase of 16.5% compared to the previous year, up double digits from the previous year (Figure 1). In addition, investment in China from around the world in 2018 was 134.97 billion USD, an increase of 3.0% from the previous year, and was a record high, as was the previous year.

In a survey conducted by JETRO from October to November 2018 for Japanese companies entering China, the companies that responded “Expansion” regarding the direction of business development in the next 1 to 2 years was 48.7%, and the ratio of companies that answered “maintaining the status quo” was 44.8% (Figure 2). The intention of business expansion in China was 38.1% in FY2015. That was the first time since the survey started in 1998 that the index went below 40%; however, it expanded 2.0 points in FY2016 to 40.1%. Furthermore, in FY2017, it significantly recovered to 48.3%, and the recovery trend of expansion also has continued this time. When companies that responded “Expansion” were asked what specific “function that will expand”, which can be multiple answers, the top 2 answers were “sales function” (59.5%), and

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“production (high value added products)” (37.4%). As sophistication of manufacturing and consumption progresses in China, it seems that Japanese companies are strengthening market development to provide superior products, technologies, expertise etc.

Despite the fact that changes in the investment climate such as rise in labor cost and investment risk in China are still pointed out, Japanese companies still view China as one of the world’s leading huge markets. It is expected that the movement to strengthen the development of the Chinese market, which will expand mainly in domestic sales type companies and industries, will continue in the future.

We also asked questions about management issues in the above-mentioned survey that allows multiple answers. According to this, the most common answer was “Rising Labor Cost” as in the previous year. The response rate was 75.7%, up 0.4 points from the previous year. Following answers are “Rising Procurement Cost” (53.5%), “Rise of Competitors (competing with costs)” (51.7%), “Difficulty in Quality Control” (48.0%), and “Stricter Environmental Regulation” (45.8%). (Table)

Japan in the Chinese Economy

Japanese companies have played a very important role in the past as China has expanded its economic scale while improving growth quality and efficiency. Regarding trade, Japan was the third largest exporter in China in 2018 by countries and regions, and the amount was 147.1 billion USD. For imports, it is the second largest with 180.6 billion USD, thus Japan is an important trading partner for China. China imports production goods such as parts, as well as capital goods such as machinery etc., and utilizes them for commercialization in China and exports them to the world. Particularly, many of the key parts and machine tools are imported from Japan.

Looking at the statics by China on investment, 23,094 Japanese companies has entered China (as of the end of 2012, China Trade and External Economic Statistical Yearbook 2013:Note), which is the No.1 by country (note that “the total number of Japanese company bases” in China was 32,349 bases by “2018 Fact-finding Survey of Japanese Enterprises Entering into Overseas Abstract Version: as of the 1st of October 2017” according to the Ministry of Foreign Affairs). It is said that direct and indirect combined employment of more than 10 million people and the contribution in the job creation aspect is significant.

In addition, many of Japanese companies have excellent technologies, expertise etc., contributing to improving the technical capabilities and management efficiency of Chinese enterprises and strengthening competitiveness in both order receiving and ordering. Moreover, in supply chains of some industries, there are also high presence of Japanese companies in the supply of key parts such as high-tech products and special raw materials in which it is difficult to find an alternative.

Japanese companies are striving to develop with China in the future as the economy becomes globalized and supply chains become complicatedly intertwined.

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Japan-China Third Country Business Cooperation and Japanese companies

Ministry of Foreign Affairs and the Ministry of Economy, Trade and Industry of Japan signed a Memorandum of Understanding with China's National Development and Reform Commission and the Ministry of Commerce on 10th of May 2018 regarding Japan-China private economic cooperation in third countries. According to the Memorandum of Understanding, both Japan and China agreed that Japan-China economic relations are highly complementary, and the companies in both countries have their respective strengths, hence promoting business between private companies and expanding Japan-China business in third countries would be beneficial to the expansion of cooperation in the economic areas of both countries and also to the development of target countries. Moreover, with the private economic cooperation projects in third countries in mind, It was agreed to establish and operate the "Japan-China Third Country Market Cooperation Forum" for business owners of a wide range of enterprises and relevant government officials to attend, aiming for further promotion of exchange between private companies in Japan and China.

Under such agreement between two countries, the Ministry of Economy, Trade and Industry and the Ministry of Foreign Affairs of Japan, along with the Ministry of Commerce and the National Development and Reform Commission of China held "the First Japan-China Third Country Market Cooperation Forum" at the People's Congress Hall in Beijing on 26th of October 2018. Approximately 1,500 people including the leaders of political and financial circles in Japan and China participated in active discussions. In addition, at the same time as the forum was held, a total of 52 cooperation memorandums of understanding were signed between the governments and businesses of the two countries across a wide range of fields, including infrastructure, logistics, IT, healthcare and finance etc.

Furthermore, 4 subcommittee meetings for "Transportation and Logistics", "Energy and Environment", "Industrialization and Financial Support (IoT, New Economy, Healthcare etc.)" and "Regional Development (EEC, Industrial Park, Smart City etc.) were held at the forum.

At each subcommittee meeting, opinions were exchanged for further cooperation between Japanese and Chinese companies in third countries, based on the introduction of initiatives of Japanese and Chinese companies. At the Regional Development subcommittee meeting, the head of the secretariat of the EEC Committee and Thai companies introduced their initiatives regarding the EEC (Eastern Economic Corridor) in Thailand, and active discussions were held on cooperation between Japanese, Chinese and Thai companies. The meeting between the Minister of Economy, Trade and Industry Seko and the Minister of Commerce Zhongshan was held in conjunction with the Forum, and at the meeting it was confirmed that the Forum has achieved great results with regard to third country market cooperation, and it was agreed that we could cooperate to make the projects progress further in the future.

After seeing these results, based on the business cooperation memorandum of understanding between JETRO and the China Council for the Promotion of International Trade (CCPIT), the "Japan-China Workshop on Business Cooperation in Thailand" sponsored by JETRO and CCPIT was held for the first time in a third country on 2nd of April 2019 and approximately 300 participants

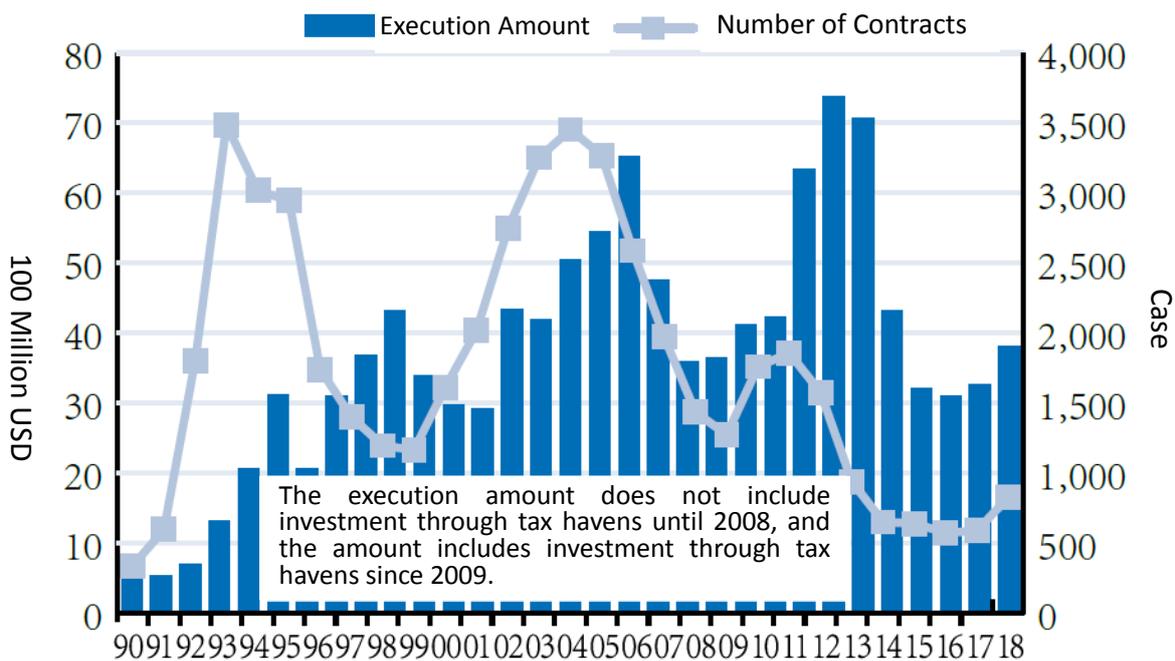
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attended, including the public and private sectors in Japan, China and Thailand.

Thus, with the recognition of cooperation at a high level between Japan and China and while cooperation in the third country market of both countries continues, Japanese Chamber of Commerce and Industry in China recognizes that it is beneficial for expanding cooperation in the economic fields of both countries and the further development of target countries by promoting business between private companies and developing their business in third countries. We want to play a role to help the cooperation between Japanese and Chinese companies in “Japan-China third country market cooperation”. In addition, we hope that the government of China provides opportunities and information that will lead to creation of specific business opportunities for Japanese companies regarding “Japan-China third country market cooperation”.

Note: Since 2014 version, the statistics on the number of companies by country have not been published in the China Trade and External Economic Statistical Yearbook.

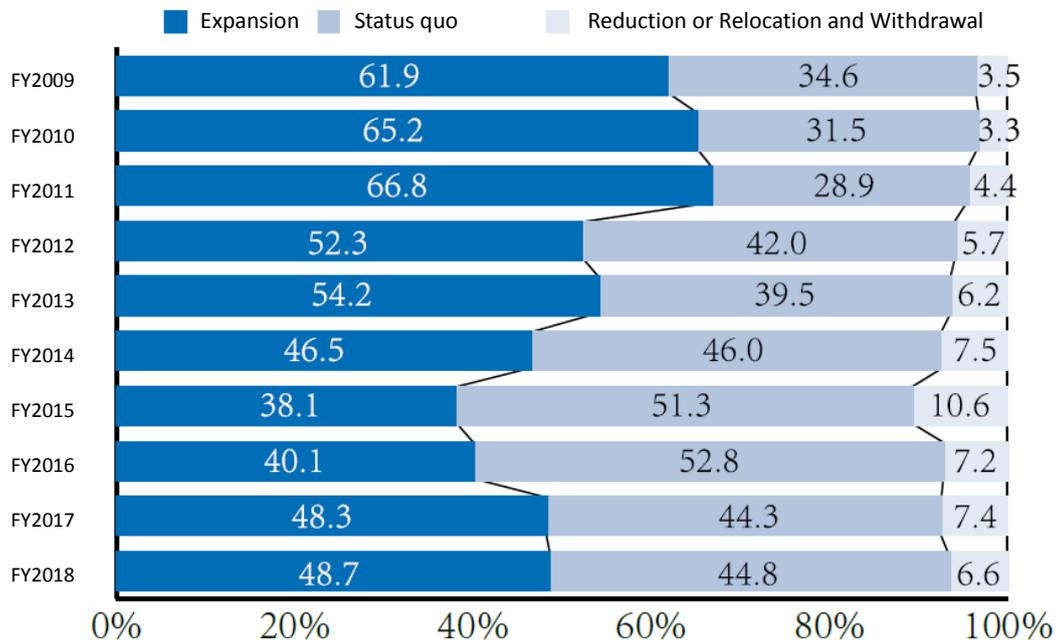
Figure 1: Japan’s Investment in China



Source: Ministry of Commerce, CEIC

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Figure 2: Direction of business development in the next 1 to 2 years



Source: JETRO "Survey on Japanese companies in Asia and Oceania"

Table: Management Issues (Top 10 items in all areas in China, multiple answers)

	Answer Item	2018 Survey (%)	2017 Survey (%)	Change (point)
1	Rising Labor Cost	75.7	75.3	0.4
2	Rising Procurement Cost (Manufacturing only)	53.5	50.2	3.3
3	Rise of Competitors (Competing with costs)	51.7	55.0	-3.3
4	Difficulty in Quality Control (Manufacturing only)	48.0	50.2	-2.2
5	Stricter Environmental Regulation (Manufacturing only)	45.8	39.3	6.6
6	Difficulty in hiring employees (general workers) (Manufacturing only)	44.0	39.1	5.0
7	Development of New Customers Is Not Progressing	43.4	39.9	3.5
8	Cost Reduction Approaching the Limit (Manufacturing only)	43.0	46.1	-3.1
9	Employee Quality	42.0	44.3	-2.3
10	Difficulty in hiring employees (technicians) (Manufacturing only)	40.3	36.8	3.4

Source: JETRO "Survey on Japanese companies in Asia and Oceania"