

Executive Summary

Direction of Chinese Economic Reform and Major Proposals

Expectations on comprehensive deepening of reforms

In March 2015, the National People's Congress ("NPC") recognized that China's economic development has entered a "new normal" and emphasized the need to deepen reforms based on this recognition. The year 2015 has been recognized as crucial for comprehensively deepening reforms and a critical year for ensuring steady growth and making structural adjustments.

Japanese companies expect that the year 2015 will be the year in which further reforms will be made to develop a "highly transparent" business environment "ensuring fairness." Japanese companies will spare no effort in supporting China's efforts to deepen reforms through their various businesses.

At the NPC, the Chinese government has pointed out the importance of deepening reforms by establishing a modern market system, transforming government functions, and creating a new, open economic system. The following are issues that Japanese companies have experienced in the ordinary course of business in China; we have classified them according to each sector.

Improvement of the modern market system

In the Report on the Work of the Government, the NPC stated the importance of completely relinquishing powers that should be delegated to the market or society. In addition, the NPC emphasized the need to promote the introduction of a unified market entry plan and the abolishment of various regulations that impede fair competition. As such, in this white paper, we will respectfully request that various systems that impede fair competition be abolished or reviewed so as to ensure the market mechanism in due consideration of the NPC's new direction.

- **Investment:** *With regard to issues related to unclear system administration which are regarded as risks facing foreign companies investing in China, we respectfully request that you make improvements contributing to increasing predictability, such as through the unified interpretation of the legal system, a sufficient period to prepare for changes to the legal system, simplification/streamlining of various procedures, and written responses to applications/inquiries.*
- **Competition laws:** *A lack of detailed guidelines for regulations set out in Article 17 of the Anti-Monopoly Law (abuse of dominant market positions) and unclear boundaries between legal and illegal cases have resulted in increasing the discretion of the authorities and impeding corporate activities. We would like to request that you clarify these insufficient action guidelines by issuing specific guidelines.*

The Report on the Work of the Government emphasized the importance of facilitating the liberalization of interest rates and enhancing the global settlement services of the RMB. Progress has been made in a number of areas so far, such as the deregulation of upper limits of interest rates on deposits, the

further opening up of the financial market including approval on the establishment of private banks, the development of a multi-stratified financial market, and the enhancement of financial products. We warmly welcome this progress and determined efforts. However, we would also like to request that you accelerate deregulation as regulations still remain, primarily related to capital transactions.

- **Banks:** *The liberalization of financial services is believed to have a large impact on China's real economy, corporate activities, and the business environment of the financial industry. Therefore, we would like to request that you clarify liberalization schedules and roadmaps to the extent possible in the future.*
- **Securities:** *The effective development of capital markets in China has been adopted as the government's policy at the 3rd Plenary Session. However, we continue to request that you consider expanding QFII and RQFII investment facilities for attracting abundant investments from Japan and other countries to China and further facilitating domestic capital markets.*

In addition, the Report on the Work of the Government pointed out the importance of facilitating business startups and innovation, cracking down on infringements, and ensuring inventions and creative work are thoroughly protected to keep innovation thriving. There has been progress in several areas, such as the installation of "Intellectual Property Courts" and the introduction of new rules contributing to resolving misappropriated application issues related to trademarks and the enhancement of trademark protection. However, as acts of illegal copying become more sophisticated and complicated, we would like to request that you take appropriate action in response to the changes in the situation.

- **Intellectual property rights:** *We would like to request that you clarify standards to recognize reoffending, for example, by identifying cases in which the same person commits counterfeiting under a different company name as reoffending, and share information on detection and penalties among the central and local administration for industry and commerce, the Administration of Quality and Technology Supervision, the General Administration of Customs, and public security agencies. In addition, in order to prevent reoffending, we would like to request that you further facilitate criminal transfers between administrative agencies and public security agencies in addition to maintaining closer relationships with rights holders through such measures as providing rights holders with information held by the General Administration of Customs. We would also like to request that you make appropriate progress in the application of stringent laws against reoffending and implement these activities nationwide.*
- **Intellectual property rights:** *We would like to request that you develop legal systems so as to clarify laws and regulations in which administrative agencies identify the concerted action of counterfeit dealers as a violation of rights and recognize copycat crimes as indirect infringements of design rights. When brand name labels and counterfeit goods without brand name labels are separately found, it should be objectively determined that such brand name labels are intended to*

be put on such counterfeit goods. Accordingly, we would like to request that you develop legal systems under which the authorities may confiscate counterfeit goods in such cases.

Transformation of government functions

The Report on the Work of the Government emphasized the importance of doing away with the requirement for government review or delegating more powers to lower-level governments, cancelling all non-administrative review, and completely removing local government authority that should be delegated to the market and society. The State Council departments abolished or delegated 246 administrative review items to lower levels in 2014 and have facilitated management innovations and strengthened services.

Simplifying and speeding up administrative procedures and abolishing the need for administrative approval or certificates that exceed the minimum requirements are also pointed out in this white paper as strong requests from Japanese companies in many fields and we hope the government will actively work on them.

- **Chemical products:** *With regard to data necessary for the GHS Classification (physical hazards) and physicochemical data which must be described in the registration of hazardous chemicals, we strongly request that you allow entities to use physiochemical data that has been developed by a company itself on its own responsibility, in addition to test data held by foreign GLP laboratories and domestic test organizations with the qualifications of appraisal as well as data that is posted in authoritative databases. In addition, we would like to request that you simplify procedures, for example, by not requiring companies to conduct physical hazard appraisal when chemical goods are classified as hazardous chemicals through GHS Classification based on an entity's internally developed data.*
- **Wholesale industry:** *An increase in the number of items handled is essential for wholesale distributors to increase business volume and will lead to the promotion of value chains of the industry including the retail and manufacturing industries. However, regulatory procedures to apply for the expansion of business scope are taking longer than expected. In addition, since the number and details of necessary documents differ according to the person in charge, we would like to request that improvements be made.*

The Report on the Work of the Government pointed out the necessity of making continued efforts to resolve excess production capacity and address challenging issues of energy saving/emissions reduction and environmental protection while setting numerical targets. In order to strengthen supervision and tighten penalties against violators, the Environmental Protection Law has been amended and efforts have been made to resolve excess production capacity based on the guiding opinions related to the reduction of serious excess production capacity.

While we understand that these efforts are effective for China to achieve sustainable growth, we would like to request that you take note of the following points when implementing these activities:

- **Energy saving and environmental protection:** *The amendment of the Environmental Protection Law has resulted in the tightening of penalties against violators. While Japanese companies are determined to make the utmost effort to comply with laws and regulations, we would like to request that local governments implement supervision and controls based not on the individual judgments of the persons in charge but on unified standards applicable to both domestic and foreign companies, so that Japanese companies are able to fully comply with the laws and regulations. In addition, we would like to request that, when executing new regulations, you give necessary consideration to existing facilities, for example, by applying a grace period and/or transitional measures. We would also like to request that the central government, the local governments, environmental NGOs, and related parties cooperate to tighten controls and enforce penalties against violators.*
- **Cement:** *There are cases where production lines in operation are pressured by local governments to cease operation without any legal or scientific basis. Such pressure to cease operations is a disincentive to companies that intend to contribute to the development of the regional economy and also, unfortunately, threatens the employment of local employees. We respectfully request the central government to provide adequate instructions to local governments.*

Establishment of a new and open economic system

The Report on the Work of the Government pointed out the importance of working actively to explore the management model of pre-establishment national treatment in addition to a negative list by halving the number of industries in which foreign investment is restricted. In the 2015 Catalogue for the Guidance of Industries for Foreign Investment, the number of items restricted was reduced from 79 to 38 compared to the 2011 catalogue. In addition, the foreign investment law that anticipates the management model of pre-establishment national treatment and the negative list are now under preparation. These are important steps for China to develop a more open market. However, we would like to request the further application of global standards in order to adjust to the globalizing economy.

- **Technical standard/certification:** *With regard to the introduction of a network security review regime announced in May 2014, we would like to request that you give consideration to systems and operations so as not to treat foreign products in a discriminatory manner. When strengthening cyber security through the application of controllable technologies in the banking and telecommunication industries, we respectfully request that you apply a transparent process and treat domestic and foreign interests equally.*
- **Information communication:** *“Notice on Launching the Pilot Program for Mobile Communications Resale Business (MIIT Notice No.[2013] 191)” issued by the Ministry of Industry and Information Technology on May 17, 2013 has provided a way for private companies to enter basic communication services. However, a relatively strict condition is imposed on foreign companies: “When new entrants are listed overseas, foreign capital participation must be less than 10%.” The*

significance of allowing private participation is to improve management efficiency and increase the quality of service through the introduction of competition. We believe introducing the expertise and experience of foreign companies will contribute to the sound development of the industry without engaging in price competition. When implementing the official plan after completing the pilot plan, we respectfully request that you loosen the regulations on foreign companies so that customers in China will be able to choose from a wide range of options that meet the necessary requirements, such as desired product quality level.

Japan in the Chinese Economy

While China has been expanding its economic scale by enhancing the quality of its growth and effectiveness, Japanese companies have played a very important role. In trade, Japan was ranked second to the United States at USD 149.4 billion in the export market of China in 2014. For imports, Japan was ranked second to South Korea at USD 163.0 billion, which means Japan is the most important trade partner for China. China imports production goods (e.g. parts) and capital goods (e.g. machinery) and exports finished goods that are assembled in China using these parts, to the world. Core parts and machine tools, among other things, are mainly imported from Japan.

The number of Japanese companies that have entered China amounted to 23,094 as of the end of 2012, and they accounted for 7.9% of all foreign companies in China, being ranked first. Japanese companies are said to employ more than 10 million people directly and indirectly so that they make a significant contribution to job creation. They try to develop a good working environment and enhance benefits programs.

As many Japanese companies have excellent technology and know-how, they help Chinese companies to strengthen their technology, business efficiency and competitiveness on both the supplier and customer sides. In supply chains in certain industries, Japanese companies enjoy a high presence due to supply of their core parts and special raw materials for high-tech products that are difficult to replace with other products.

As the economy is being globalized and supply chains are becoming more complicated, many Japanese companies want to continue developing with China but certain companies have changed their intention of investment in line with changes in the business environment, which will be described later in the Reference section.

We expect that China will develop an investment environment that enables Japanese companies that aim at developing with China to continue to actively work on businesses in the country. This will be achieved precisely through the comprehensive deepening of reforms pointed out at the NPC as the focus area for 2015. We look forward to seeing further progress in the reforms. This white paper summarizes an analysis of the issues that Japanese companies engaged in business in China over the long term have faced and proposals to resolve them, and we believe this paper may provide the Chinese government with useful information with which to promote its reforms. We would be pleased if the Chinese government refers to some of our proposals for future policy management.

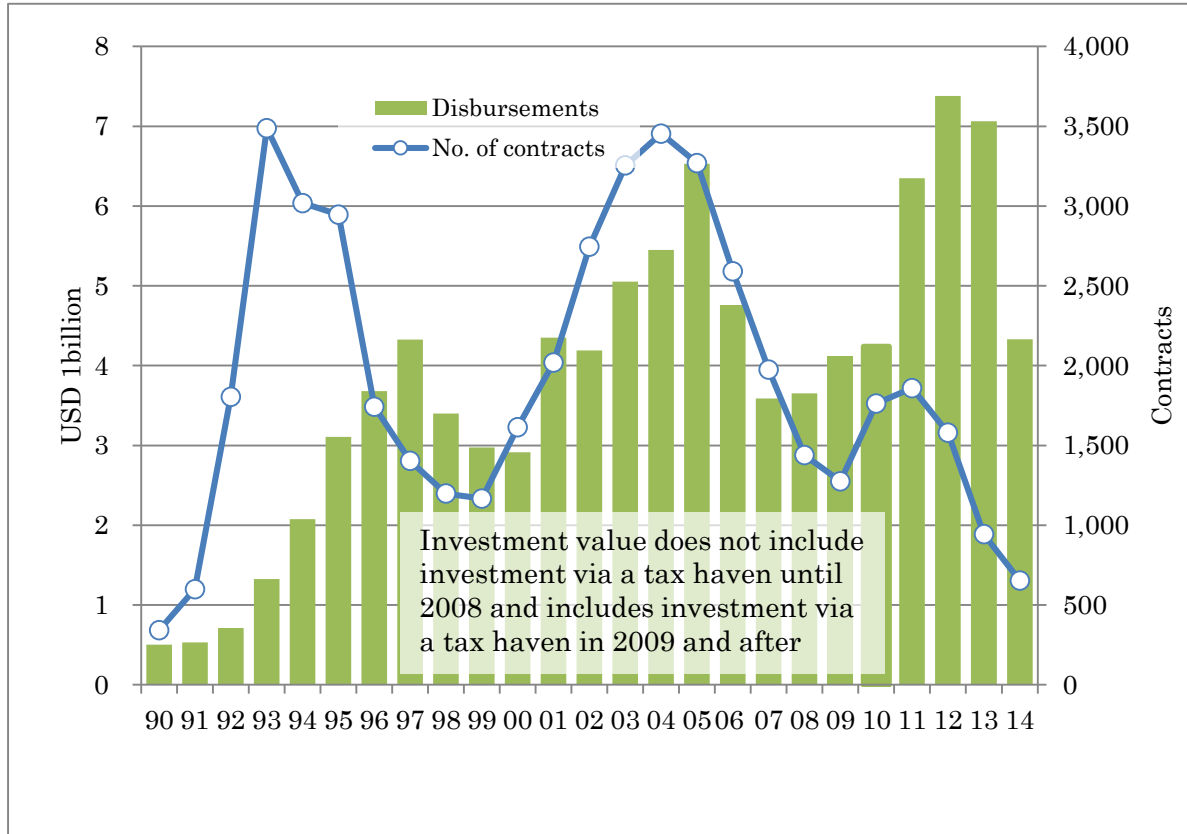
Reference: Japanese companies' investment in China

In 2014, Japanese investment in China decreased 38.8% year-on-year to USD 4.3 billion, experiencing a decrease for two consecutive years (Figure 1). While Japanese investment hit a record high of USD 7.4 billion in 2012, it has been on a decline since the latter half of 2013. That seems to be partly due to changes in the investment environment in China including an increase in personnel costs and the increasing difficulty in securing a sufficient workforce as well as the growing interest of Japanese companies in expanding business in ASEAN.

According to a survey conducted by JETRO from October to November 2014 (Figure 2) with regard to companies' intention to invest in China in the next year or two, the ratio of companies which answered they would "increase" their investment was 46.5%, down 7.7 points year-on-year, and those who answered "maintain the same level as now" was 46.0%, up 6.5 points (Figure 2). With regard to Japanese companies' intention to expand their businesses in China, the ratio of "increase" decreased significantly (from 66.8% to 46.5%) compared with 2011. While the details are omitted, the ratio of companies which responded "increase" is low in an industry with a high export ratio and the ratio of "increase" is high in an industry with a high ratio of domestic sales.

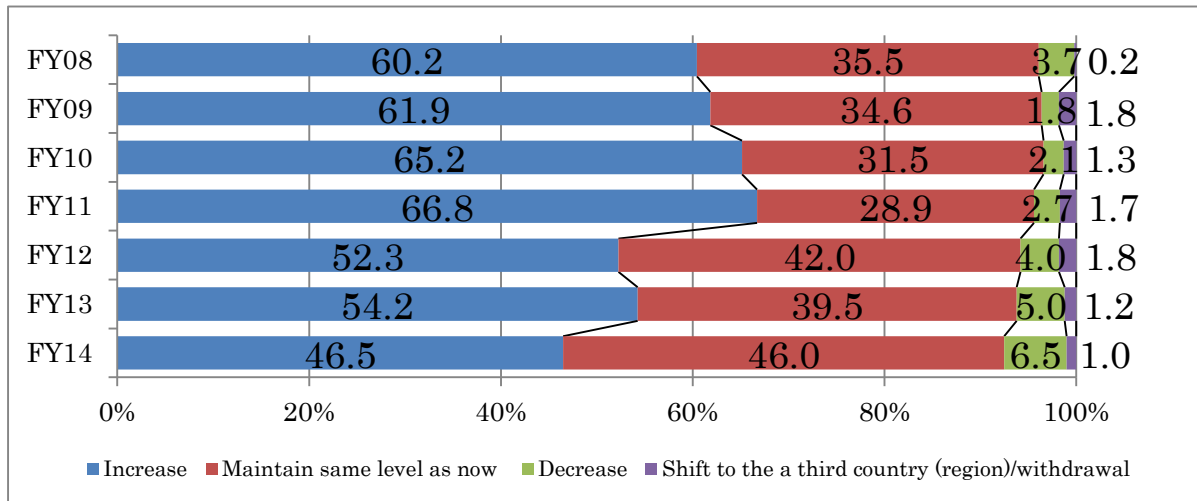
The background to this is likely a decline in the attractiveness of China to export-oriented companies in line with changes in the investment environment. Meanwhile, domestic sales-oriented companies continue to see China as a promising market and are expected to accelerate market development in China.

Fig. 1: Trends in 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 Japanese companies' activities in Asia and Oceania," JETRO