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Direction of Chinese Economic Reform and Main Proposals

Expectation for Further Deepening of Reform

In the 13th five-year plan (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 policy to promote structural adjustments through the reform and emphasize the importance of the role of market in the 13-5 Plan.

Furthermore, in the government activity report (hereinafter referred to as the Government Activity Report) in the first meeting of the 13th National People's Congress (NPC), based on the achievement status of the 13-5 Plan, the priority activity missions in 2018 were established. The top priorities cited there was to steer and implement structural reforms that is represented in "eliminating overproduction capacity, eliminating excess real estate inventory, preventing and eliminating financial risks, reducing company costs and expanding effective supply". In addition, the policy is to strive to simplify administration, reduce taxes, lower the share of insurance premiums of "five insurances and public housing fund" to continuously improve the business environment, enhance the quality of economic development, and revitalize corporate activities. In addition to this, it highlighted the development of a world-class business environment by conforming to economic and trade rules that are internationally used by completing the relevant laws and regulations making protection of property rights, contract compliance, unified market, equal market, fair competition as the basic policy.

Japanese companies are hoping that the year 2018 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.

In the 13-5 Plan and the Government Activity Report in 2018 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

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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.

- **Labor** : There are still situations where expatriate employees working in China have to pay social insurance premiums in duplicate in both Japan and China. Representatives including short-term expatriate employees paying social insurance premiums in duplicate in Japan and China are heavy burdens for Japanese companies located in China. Meanwhile, on the 9th of May 2018, the Foreign Ministers of Japan and China signed the “Agreement between the Government of Japan and The Government of the People’s Republic of China on Social Security” (Japan-China Social Security Agreement) and it is welcomed as significant progress. We propose that both the Japanese and Chinese governments swiftly implement the work and adjustment necessary for the early entry into force of the agreement, such as the domestic procedures in each country, so that the burdens on Japanese companies and expatriate employees will be promptly reduced.

- **Competition Law** : There are cases where business mergers between Chinese enterprises are approved even if the domestic share after merging becomes extremely large, especially in mergers between state-owned enterprises. The judgment criteria such as the ruling provision and the method of defining the market scope are unclear, and at the same time, as monopoly and oligopoly progress, the barriers to entry into the Chinese domestic market in that field will also increase. In such cases, from the viewpoint of improving the transparency of business merger review, we propose the policy underlying the application under the Antitrust Law to be published.

- **Automobile** : As in the case of EV vehicles, we propose that hybrid vehicles that were not subject to credit additions to be allowed a surcharge factor for each sale in the “Parallel Administrative Measures for Passenger Car Enterprise’s Fuel Efficiency and New Energy Vehicle Credit”. Moreover, we propose the introduction of a system that allows for credit purchase (fines) from the government if the prescribed target value cannot be achieved. Furthermore, in the case NEV (New Energy Vehicle) regulation is introduced after 2021 in the future, we propose the establishment of an appropriate enforcement ratio and early official

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proclamation.

The government revealed the determination to complete the intellectual property rights system that is advantageous to encourage innovation in the 13-5 Plan. Furthermore, in the NPC held in March of 2018, implementation of the reform of the State Council structure was decided. The government aims to raise administrative efficiency and its enforcement capability through unification of administrative functions, which had been crossing over, as a goal of the structural reform. Through structural reform, it is expected that issues that had been raised due to differences in judgment by a plurality of administrative organizations in competition law and intellectual property rights field will be resolved. As Japanese companies are strongly hoping for improvements on these issues, we propose appropriate approaches.

- **Intellectual Property Rights** : As for the abuse of intellectual property rights which is a violation of the Antitrust Law, analysis and judgment factors such as abuse etc. are being reviewed in the “Antitrust Guidance on Intellectual Property Rights Abuse (Public Comment)”. To this end, from the viewpoint of securing non-discriminatory status, we propose that it is necessary to clarify not only the analysis and judgment factors of abuse, but also the specific criteria for judgment of the factors to avoid generally justifiable exercise of intellectual property right which is an exclusive right to be easily judged as an abuse of intellectual property right. Moreover, regarding judgment rules and guidelines for standard concerning the abuse of intellectual property rights, which at present similar judgment rules are stipulated by multiple government-affiliated agencies, we propose the formulation of the only unified standard (guidelines) across multiple government-affiliated agencies.

- **Intellectual Property Rights** : In the case intellectual property rights related to multiple administrative organizations, such as design rights and trademark rights, are granted to one product, and they are infringed at the same time, and the right holder makes a claim for infringement relief to one of the above-mentioned multiple administrative agencies; we propose that one of the administrative agencies cooperates with the other administrative agencies in the above multiple agencies to take countermeasures such as simultaneous censure implementation, i.e. to strengthen cooperation among administrative agencies in dealing with infringement.

- **Chemicals** : Hazardous chemicals are under the jurisdiction of several departments, and regulations based on two different concepts of dangerous chemicals and dangerous goods coexist. For this reason, different regulations with different concepts are applied at different stages from multiple departments for the same chemical, which may inevitably lead to inefficient management. In the administrative division conducting management supervision, we propose that uniform judgment criteria be adopted.

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Deepening the Reform of the Administrative Management System

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, the administrative review and approval items of the State Council department were reduced by 44% in the past 5 years, and administrative review and approval outside the framework of the Administrative Permit Acts were completely abolished. 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 government is planning to deepen reforms including “simplification of administration and authority transfer”, “combining relief and management” and “optimization of services” in 2018, we propose more intense efforts to develop. In addition, further improvements related to improving business foreseeability, such as securing a sufficient preparation period for system change and unification of system operation and interpretation, are required in many fields.

• **Logistics** : With the expansion of integrated customs clearance, the unification of the system has been promoted, and in some items, some improvements have been seen in the operation of the system such as it become paperless to facilitate the efficiency of screening procedures etc. However, due to frequent updating, stability is lacking, and troubles of the system itself often cause delays in making arrangement, as well as poor coordination among systems, regional differences in system level and method of operation, etc. still exist. We propose further promotion of system stabilization and unification.

• **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. As Japanese companies, we intend to work with integrity as to compliance with laws and regulations, but in order to properly comply with laws and regulations, we propose that it is not an arbitrary response of the person in charge in terms of execution, such as surveillance and control by local government etc. but operation should be based on unified standards etc. and be done regardless of domestic and foreign enterprise. 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.

• **Chemicals** : Environmental inspection by the central government and the implementation of stricter atmospheric special emissions restrictions in Jingjinji (Beijing, Tianjin, Hebei Province) Air pollution transmission route cities (hereinafter referred to as “2+26 cities”) had great effect on environmental improvement by controlling illegal pollutant discharge, curtailment or closure of “companies producing and emitting pollutant”. However, some local governments have enforced

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uniformed (one size fits all) crackdown on environmental regulations and stopped production uniformly in order to respond to environmental inspection by the central government or special restriction request of “2+26 cities”, regardless of whether emission standards are met or not,. At that time, companies that met emission standards were also ordered to shut down production for several months, which had a major impact on corporate operation or production. We propose the government to take measures to eliminate such adverse effects caused by uniform crackdown on local areas by setting the criteria for crackdown to see whether the company complies with the national environmental protection laws and standards or not.

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 June 2017, the “Foreign Investment Industry Guidance Inventory (revised in 2017)” was published and further relaxation of regulations for foreign investment to entry into the service industry, manufacturing industry, mining industry etc. will be carried out; thus the initiatives for the Chinese market to become more open are progressing. In the Government Activity Report, it states “the opening up at a higher level and in a wider range, which will make the structure and arrangement, system and mechanism more complete”, hence we propose a proactive approach toward further opening up of the fields regulated by foreign investment entry regulation, and further adoption of global standards.

• **Technical Standards and Certification** :The Cyber Security Law, which came into effect on the 1st of June 2017, and the National Internet Information Office has made an statement that its detailed contents will be clarified by requirements, bylaws, standards etc. However, we propose that in the process of establishing these bylaws and standards, the opinions of stakeholders including foreign companies be taken into consideration and the establishment of systems and operations that do not handle foreign products discriminately.

• **Information and Communication** : It is essential for companies to secure security when using information communication, and cases of building their own Internet VPN for their own business purposes within the company are increasing. However, recently, communication connection on Internet VPN is getting worse. Such a situation impedes the business activities of foreign companies and is a factor that hinders the development of the domestic economy utilizing foreign capital. We propose the establishment of an environment where Internet VPN for business purposes can be stable.

• **Software** : Issues such as environmental pollution, traffic congestion, medical and aging, education, energy conservation, etc. are some of the policies that the central government and local governments are most focused on. ICT-related Japanese companies have developed many solutions based on advanced technology in these areas. We propose the

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enhancement of information disclosure and expansion of entry opportunities in relevant development in these fields.

• **Banking** : In various places in 2017, events such as large dividend remittances, remote company settlements, outward lending operations, etc. could not be traded in external payment of foreign currency or RMB. Since interference with legitimate external settlement based on the actual demand of the enterprise can be regarded as a potential risk against investment in China, we propose operation with high transparency, such as not limiting settlement unless there is a clear prohibition provision in laws and regulations. We also propose the establishment of definite foreign exchange controls regulations that are unified throughout the country.

Main Items That Have Been Improved from the Last Year's Proposals

The main items that showed improvement from 2017 proposals 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 have some issues that require further improvement. In addition, there are still many other areas expected to improve, and we hope that the government will continue to make efforts for improvement.

- 1) Issuance of RMB denominated onshore bonds (Panda bonds) by Japanese companies (2017 White Paper, p252, proposal④)

On the financial side, we understand that the liberalization of financial market is progressing steadily, such as the issuance of RMB denominated onshore bonds (Panda bonds) by Japanese companies in 2017. We expect that the movement towards liberalization will further accelerate in the future.

- 2) Revision of Foreign Investment Industry Guidance Inventory (2017 White Paper p34, Proposal⑤)

The revised version of the “Foreign Investment Industry Guidance Catalog” that came into effect in July 2017 reduced restricted measures against 30 items compared to the 2015 version catalog, and certain amount of relaxation of regulation has advanced.

- 3) Reduction of Social Security Insurance Rate (2017 White Paper, p54, Proposal②)

On the 5th of March 2018, a policy of further reducing the corporate tax burden and other burden as a part of the supply-side structural reform was indicated in the Government Activity Report of the NPC. Efforts to further draw out the vitality of companies that are market-based, such as continuing to lower the insurance premium payment ratio of corporations “five insurances and public housing fund (endowment insurance, unemployment insurance, medical insurance,

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workers accident compensation insurance, maternity insurance, and public housing fund)", are welcomed as the signs of concrete demonstration.

4) Revision of Cosmetic Products Safety Technical Code (2017 White Paper, p162, Proposal⑤)

In June 2017, the "Notice of Soliciting Proposals for Revision of Cosmetic Products Safety Technical Code for 2017" for improving Cosmetic Safety Technical Code was announced. We are grateful for inviting suggestions based on this notification as an effort to unify the cosmetic products inspection standards and to facilitate the inspection process.

Initiatives for Chinese Business by Japanese Companies

Japan's investment in China in 2017 increased by 5.1% to 3.27 billion USD from the previous year and turned to increase from the fourth consecutive year of decline until the previous year (Figure 1). Furthermore, the amount of investment from the world in 2017 also increased by 4.0% (USD base) as compared with the previous year, and it began to increase from the previous year when it decreased for the first time since 2012 and recorded the highest ever.

In a survey conducted by JETRO from October to November 2017 (Figure 2) for Japanese companies entering China, the companies that responded "Expansion" regarding the direction of business development in the next one to two years was 48.3%, and the ratio of companies that answered "maintaining the status quo" was 44.3%. The intention of expanding business in China was 38.1% in 2015, and the first time it fell under 40% since the survey started in 1998. However, in FY 2016, it increased 2.0 points to 40.1%. Furthermore, it recovered significantly in FY 2017 to 48.3%. 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" (59.6%), and "production (high value added products)" (41.7%). 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 above-mentioned issues in the question that allows multiple answers. According to the results, "Rising labor cost" was listed as the highest number of answers as in the previous year. Although the response rate shrunk by 2.5 points from the previous year, it is prominent at 75.3%, which shows the magnitude of the problem (see Table). It is followed by the answers: the "Rise of competitors (competing with costs)" (55.0%), "Rising

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procurement cost” (50.2%), “Difficulty in quality control” (50.2%), the “Cost reduction approaching the limit” (46.1%). Japanese companies are facing severe cost reduction pressures.

Moreover, in addition to “Rising procurement cost (18.3 points increase compared with the previous year)”, “Stricter environmental regulations (16.1 points increase compared with the previous year)” have increased significantly compared with the previous year, showing “Stricter environmental regulations” was a major challenge faced by enterprises in 2017.

As Japanese companies, they intend to strictly comply with laws and regulations related to environmental regulations etc., at the same time we propose that unified criteria is applied regardless of domestic and foreign capital when monitoring and crackdown are carried out by local governments, etc. In addition, we also propose that when administrative guidance etc. on companies is carried out, authorities should present the grounds for violation of laws and regulations and data etc. by the authorities in writing, and that when new regulations are to be executed and applied to existing facilities, grace period and transitional measures should be established.

Solution to the issues faced by these Japanese companies is consistent with the realization of the “Cost reduction of enterprises” and the “Beautiful China” promoted by the Chinese government. We propose the implementation of policies aimed at improvement while we also want to contribute to such issues as Japanese companies.

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 second largest exporter in China in 2017, and the amount was 137.3 billion USD. For imports, it is the second largest with 165.7 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, the number of Japanese companies in China is 23,094 companies (as of the end of 2012, China Trade and External Economic Statistical Yearbook 2013:Note), accounting for 7.9% of foreign enterprises, (note that “the total number of Japanese company bases” in China was 32,313 bases by “2017 Fact-finding Survey of Japanese Enterprises Entering into Overseas Abstract Version: as of the 1st of October 2016” according to the Ministry of Foreign Affairs) which is the number 1 by country. It is said to be directly or indirectly producing employment of approximately more than 10 million people and contributes greatly in terms of employment creation and is working to improve workplace environment and enhance welfare system.

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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.

“One Belt One Road” Concept and Japanese Companies

National Development and Reform Commission (NDRC), Ministry of Foreign Affairs and Ministry of Commerce jointly announced “Vision and Action in Promoting Cooperative Construction of Silk Road Economic Belt and 21st Century Maritime Silk Road” in March 2015. According to that, “One Belt One Road” concept aims at constructing a destiny community body that encompasses political, economic and cultural aspects. As the priority of cooperation, 5 points ①policy communication, ②interconnection of facilities and infrastructure, ③facilitation of trade and investment, ④distribution of funds, and ⑤communication between citizens were cited (so called “the Five Connectivities”).

At the “One Belt One Road” international cooperation high-level forum held in May 2017, the statement was made regarding its policy that “China has raised the ‘One Belt One Road’ initiative aiming to share the great opportunities of the development of the world and China and China welcomes all countries and international and regional organizations to actively participate in cooperative construction of ‘One Belt One Road’”.

Japanese companies are also paying attention to policies related to the concept of “One Belt One Road” and its progress. Furthermore, the Japanese Chamber of Commerce and Industry in China also believes that the concept of “One Belt One Road” will be integrated into a free and equitable economic zone of the Pacific Rim in a high-quality manner, and contribute to the peace and prosperity of the region and the world, and we would like to cooperate with this initiative from such points of view. In addition, we recognize that it is beneficial not only for both countries, but also for the development of the target countries, including the concept of “One Belt One Road” by developing both Japanese and Chinese businesses in third countries.

However, due to the lack of information such as understanding of the “One Belt One Road” concept, specific progress status, policy measures and so on, the Japanese Chamber of Commerce and Industry in China has established a “One Belt One Road Liaison Council” to fulfill the external contact window function, and is holding seminars with lecturers of Japanese Companies that are engaging in business related to the Chinese authorities concerning the “One Belt One Road” initiative.

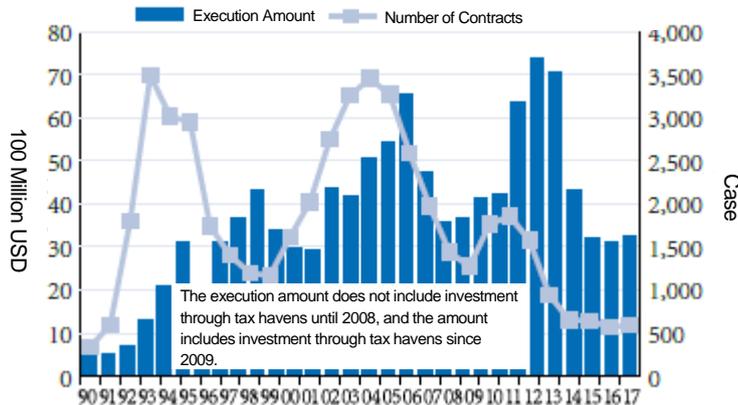
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Specific proposals regarding “One Belt One Road” initiative from Japanese Companies include: the establishment of systems and infrastructure to raise the punctuality of railway transportation so that they can be used as a foreseeable means of transportation, and policy support including infrastructure development etc. so that individual refrigerated containers can be transported at affordable price, since currently, 40-foot ordinary container is common and utilization of refrigerated container is not easy.

Furthermore, the Japanese Chamber of Commerce and Industry in China’s “One Belt One Road Liaison Council” hopes to play a role as a bridge between the Chinese Government and enterprises for Japanese companies to deepen their understanding of the concept of “One Belt One Road”, thus leading to related businesses. Therefore we propose the related authorities to provide further information. In addition, we propose the establishment of a contact window for information on related projects and exchange of information.

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.

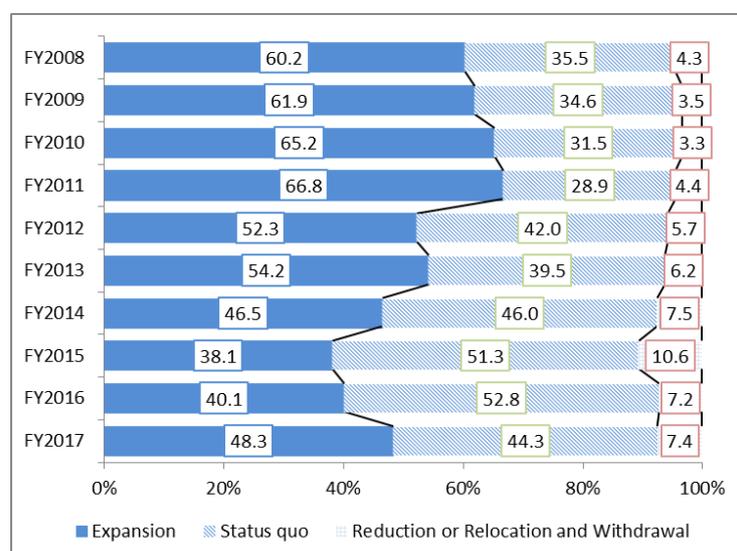
Figure1: Japanese Investment in China



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 fields in China, multiple answers)

	Answer Item	2017 Survey (%)	2016 Survey (%)	Change (point)
1	Rising Labor Cost	75.3	77.8	-2.5
2	Rise of Competitors	55.0	44.4	10.6
3	Rising Procurement Cost	50.2	31.9	18.3
3	Difficulty in Quality Control	50.2	45.0	5.2
5	Cost Reduction Approaching the Limit	46.1	48.2	-2.1
6	Employee Quality	44.3	42.4	1.9
7	Price Reduction Request From Major Customers	41.5	36.6	4.9
8	Slow New Customer Development	39.9	40.9	-1.0
9	Stricter Environmental Regulation	39.3	23.2	16.1
10	It Takes Too Long to Clear Customs	33.8	31.9	1.9

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