Section 4 The impact of industrial development on trade and investment

In the previous sections, we considered the industrial fundamentals and industrial mechanisms that underlie the rapid development of China's manufacturing industry. How has China's industrial development affected global trade and investment relations and the rules-based international economic order? What implications does that impact have for the arguments over the relationship between industrial policy and trade, which was examined in Part II, Chapter 1, Section 5?

As described in Part I, Chapter 1, Section 2, amid the economic slump following the COVID-19 pandemic, the structural problem of underconsumption has emerged, causing the stagnation of imports and escalating deflationary exports. In addition, recently, there have been signs that moves to get around the U.S.-China trade conflict are leading to an export shift to emerging and developing countries, mainly Asian countries. At the heart of this trend, which has become apparent in recent years, is China's medium- to long-term industrial development supported by the central government's industrial policies, competition between local governments, and economies of scale, which we have examined in this chapter. Having recognized the above, we will consider the impact of China's industrial development on trade and investment and the impact's implications for global trade and investment relationships and the rules-based international economic order.

1. Evolution of trade theory

Before examining the impact of China's industrial development on trade and investment, let us consider the reason why trade is conducted in the first place and the requirements for exporting countries. Traditional trade theory maintains that the structure of trade between countries is determined by the comparative advantage that arises from the differences in the availability of factors of production in the countries. Free trade is supposed to improve the economic welfare of all countries under that theory. However, the theory cannot necessarily explain why developed countries engage in trade with each other despite their small differences in terms of availability of technology and factors of production.

In contrast, new trade theory proposed by Krugman explains that trade can occur between countries that are similar to each other in terms of availability of technology and factors of production as increased variety of products increases the level of satisfaction for consumers. This theory's analysis assumes factors that were previously not taken into consideration, such as the working of economies of scale (increasing returns to scale) and the transportation cost associated with trade that is commensurate with geographical distance and transportation volume. Those assumptions arrive at the conclusion that production of a certain product tends to be located in a country with a larger consumer market. That is because the larger the domestic consumption market is, the further the manufacturing cost of the product can be reduced, as economies of scale work. Transportation cost can also be saved if the product is exported from a large country to a small country (conversely, in the case of exports from a small country, exporting a large volume of goods to a large country requires high transportation cost).[247]

[247] Tanaka, A. "KOKUSAI BOUEKI TO BOUEKI SEISAKU KENKYUU MEMO (RIETI KORAMU)," https://www.rieti.go.jp/users/tanaka-ayumu/serial/index.htm (as viewed on June 6, 2025)

As indicated above, a country with a large consumer market for a certain product tends to have a concentration of production in excess of demand for that product and become a net exporter. This tendency is called the "home market effect." The home market effect implies that when a new industry emerges due to increased domestic demand in a certain country and when economies of scale start to work, production bases may be relocated to the country from other countries. It has been pointed out that industries where economies of scale (increasing returns to scale) work strongly tend to fall into a state of monopoly or oligopoly.

On the production side as well, in industries where economies of scale work more and more strongly with the passage of time due to the learning effect or the Marshallian externality, the effects of the first mover advantage may be stronger. In that case, it is likely that in the large country benefiting from economies of scale, production expands more rapidly than in other countries, with the portion of production that is in excess of domestic demand exported to other countries. This may create trade tensions.

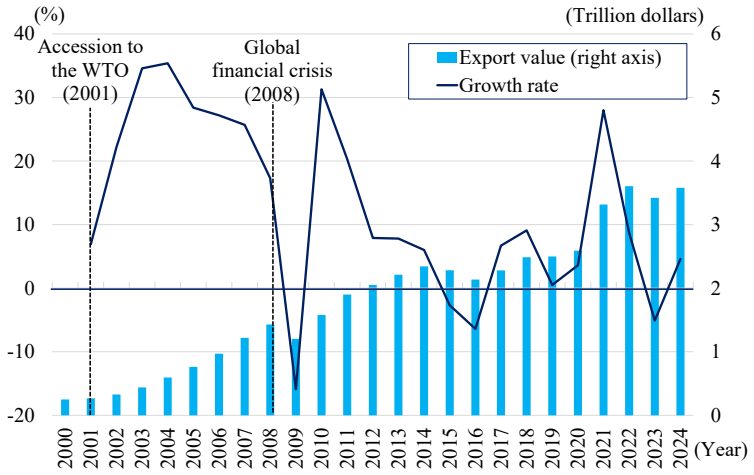
As for trade theory, later, Melitz proposed a "new new trade theory." Assuming that there are differences in productivity across companies and that fixed cost arises when companies start exporting, that theory maintains that only companies with a productivity level higher than the minimum threshold required for export engage in export activity. Trade liberalization makes it possible for more companies to engage in export activity through the reduction of fixed cost and encourages companies with low productivity to exit the market, thereby raising the society-wide productivity level, according to the new new trade theory. Helpman introduced the foreign direct investment (FDI) factor into Melitz's theory. Assuming that FDI requires higher fixed cost, Helpman maintained that companies with the highest level of productivity choose FDI and operate internationally as multinationals, companies with the second-highest level of productivity engage in export activity, and companies with lower productivity operate only domestically.

2. Expansion of exports from China

In Part II, Chapter 1, Section 1, we analyzed the China shock as seen from the angle of export destination countries as part of the study of the impact of the expansion of exports from China. Here, we will look at the situation of the industrial development and the expansion of exports as seen from the angle of China. Exports from China increased steeply after the country's accession to the WTO in 2001, supported in part by improved access to other countries' markets. (Figure II-2-4-1). In 2004, exports from China recorded a high growth rate of around 35% compared with the previous year. Between 2001 and 2008, when the global financial crisis occurred, the value of exports increased by a factor of around 5.4 and the average annual rate of growth in exports came to around 27%. The upsurge in imports from China, which Autor et al. said caused damage to employment in the U.S. manufacturing industry,[248] arose in such a short period of time.

[248] Autor et al. (2013)

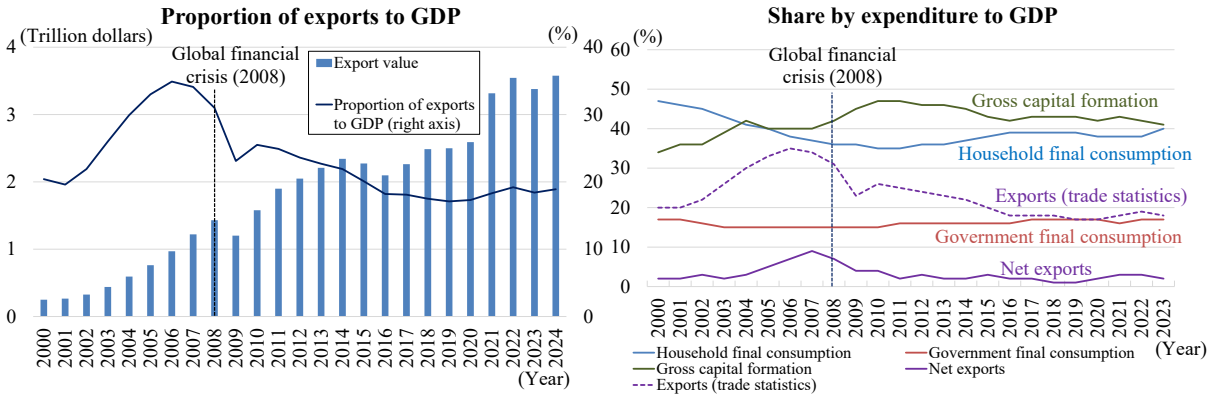
Figure II-2-4-1. Changes in imports in China



Source: Global Trade Atlas.

On the other hand, from China's point of view, the ratio of exports to GDP entered a downtrend after peaking at around the time of the global financial crisis (Figure II-2-4-2). The main factors behind the downtrend were the shrinkage of exports due to the downturn of the global economy and the expansion of domestic demand, including gross capital formation, that was triggered by the economic package worth 4 trillion yuan. However, in absolute terms, the value of exports remained on an uptrend in the long term. In short, from other countries' points of view, exports from China continued to increase.

Figure II-2-4-2. Share of exports to GDP in China



Notes:

1: China publishes trade statistics in both dollar-based and renminbi-based values. The export-to-GDP ratios in both figures are calculated using renminbi-based values.

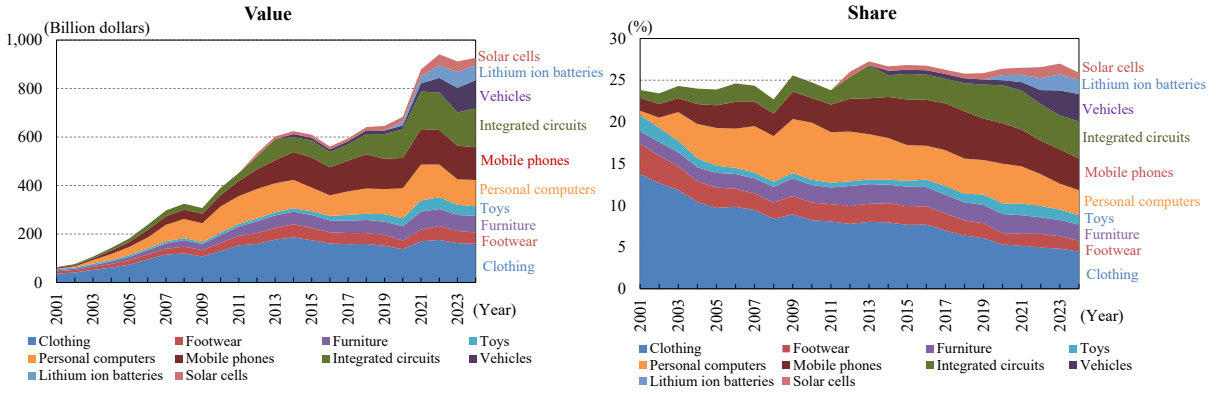
2: Until recent years, China did not separately publish its exports and imports in its GDP statistics. Therefore, the values in the figure are calculated using export data from trade statistics as a reference.

Source: National Bureau of Statistics of China, General Administration of Customs of China, CEIC.

It is necessary to pay attention not only to the expansion of exports from China in terms of volume but also to changes in the quality of export products. The trend in the mix of China's major export products shows that the shares of light industry products whose export shares were large in the early 2000s, such as clothing, footwear, and furniture, have declined sharply, although they are still major export products (Figure II-2-4-3).[249] In place of those products, personal computers recorded an increase in export share in the 2000s and the share peaked around 2010. Next, in the 2010s, the shares of mobile phones and integrated circuits increased, and the uptrend continued until the second half of the 2010s for mobile phones and until the early 2020s for integrated circuits. Exports of solar cells have also increased since the 2010s. In the 2020s, the shares of vehicles and lithium-ion batteries have expanded markedly. Regarding vehicles, since the second half of 2020, exports, mainly of gasoline-powered vehicles, have expanded rapidly, making this item a major export product. Chinese EVs have attracted international attention because of steep increases in exports, from a base of almost zero, to such markets as Europe and Thailand, although exports of EVs were smaller than those of gasoline-powered vehicles in terms of both value and volume (Figure II-2-4-4).

As described above, new industrial clusters, including clusters of advanced industries, have been created one after another in China, and have developed into export industries with established economies of scale.[250]

Figure II-2-4-3. Changes in major export products in China



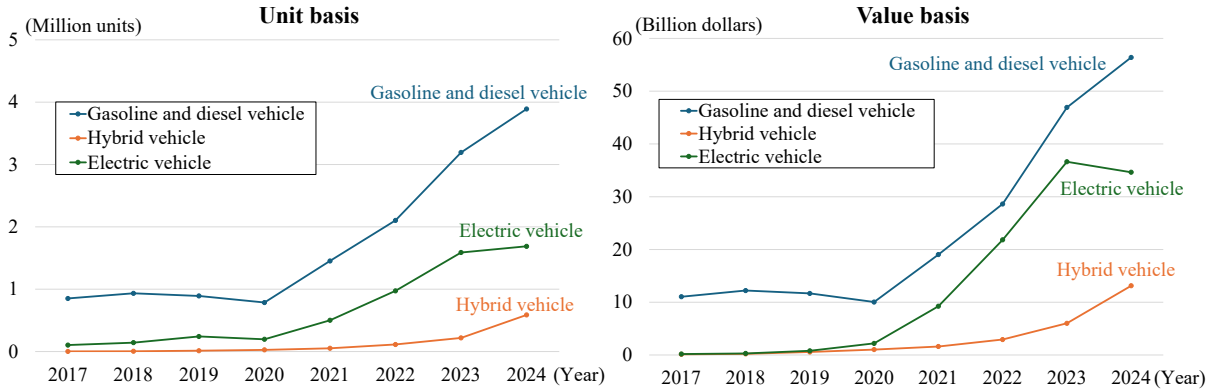
Note: The item classification is based on the classification published by China. The following items began to be disclosed from the specified years: automobiles (from 2014), lithium-ion batteries (from 2020), and solar cells (from 2012).

Source: General Administration of Customs of China, CEIC.

[249] Miura (2025). In particular, Figure II-2-4-3 was prepared in reference to Figure 4 in the report.

[250] It should be kept in mind that export products whose shares have not changed significantly, such as steel and chemicals, are not included in the figure.

Figure II-2-4-4. Changes in exports of vehicles (by motor type) in China



Note: Motors for propulsion are categorized based on the following 6-digit HS codes: buses (HS8702), passenger cars (HS8703), and trucks (HS8704). Details are as follows:

[i] Gasoline and diesel vehicles: HS870210, 870321, 870322, 870323, 870324, 870331, 870332, 870333, 870421, 870422, 870423, 870431, and 870432 (those solely equipped with a gasoline/diesel engine as a motor for propulsion)

[ii] Hybrid vehicles: HS870220, 870230, 870340, 870350, 870360, 870370, 870441, 870442, 870443, and 870451 (those equipped with both a gasoline/diesel engine and an electric motor as a motor for propulsion).

[iii] Electric vehicles: HS870240, 870380, and 870460 (those solely equipped with an electric motor as a motor for propulsion)

Note that among vehicles, tractors (HS8701), special-purpose vehicles, such as fire trucks (HS8705), and some passenger cars, such as HS870310 (snowmobiles) and others (HS870390) are excluded.

Source: Global Trade Atlas.

In addition to China's medium- to long-term industrial development mentioned above, new factors that emerged after the COVID-19 pandemic are causing changes in the trend in exports from China. First, in the post-pandemic period, the Chinese economy entered a downturn due to the real estate market slump and a deflationary trend, as described in Part I, Chapter 1, Section 2. However, as policy measures promoted investments on the production side, a structural macroeconomic imbalance in the form of domestic underconsumption emerged. As a result, recently, not only has the dependence of GDP growth on exports grown, but also, deflationary exports accompanied by falls in overall export prices are increasing as a trend. While the export price trend varies from item to item, the downtrend in export prices is clearly visible for steel and solar panels in particular.

In addition, the ongoing escalation of the U.S.-China trade conflict may cause a change in export destinations for China. At the moment, in response to the tariff policy under the second Trump administration, announced in April 2025, there are signs of a shift in Chinese exports to emerging and developing countries, including other Asian countries. This trend may change depending on the future course of the U.S. tariff policy and China's response, so it is necessary to keep a close watch on future developments. There are concerns that those new factors, that is, the increase in exports accompanied

by drops in export prices and the change in export destinations, could escalate the trade conflict amid the trend of global economic slowdown.

What was described above is a phenomenon that has emerged recently, but in relation to the assessment of China's industrial development mechanisms, there are arguments as to how the expansion of exports from China after the accession to the WTO, as an underlying medium- to long-term structural change, should be interpreted. Bown argued that China's industrial policies, including industrial subsidies, may have created international external diseconomies and caused trade terms to deteriorate for other countries, as they had the effect of impoverishing trading partner countries.[251,252] Bown asserted that the existing WTO Agreements and dispute settlement procedures have been unable to effectively deal with policy measures that have the effect of impoverishing trading partner countries. Watanabe paid attention to the economies of scale established by China's industrial policies and pointed out the risk of a "market failure" occurring, with the benefits of economies of scale concentrated in a particular country that has gone it alone in implementing industrial policies while other countries bear the costs.[253] Watanabe mentioned that in order to deal with this problem, it is necessary to create an ex-ante system to prevent the monopoly of the benefits of scale by a particular country and an ex-post system to prevent the abuse of economic control when monopoly has occurred. It can be said that the point argued above is the most important structural problem that is shaking the current rules-based international economic order and poses a challenge that we cannot avoid when planning to strengthen or rebuild that system.

3. Increasingly vigorous outward FDI from China

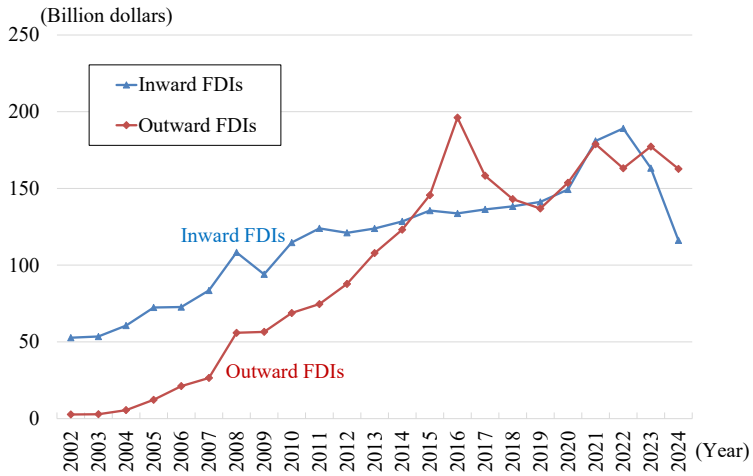
In recent years, Chinese outward FDI activity has been becoming more and more vigorous. The value of outward FDIs from China, which was almost zero in the early 2000s, gradually increased and surpassed the value of inward FDIs in China around the middle of the 2010s (Figure II-2-4-5). Around that time, outward FDIs from China represented mainly M&As, with greenfield investments accounting for a relatively small portion (Figure II-2-4-6). However, against the backdrop of the depreciation of the yuan in exchange markets and rapid falls in foreign currency reserves in 2015, China imposed strict controls on outward FDIs, so the value of outward FDIs started to decline after peaking in 2016. Afterwards, around 2019, outward FDIs started to increase once again. At this time, mainly greenfield investments increased.

251 Bown (2024)

252 It has also been mentioned that China itself received a "negative impact," with its terms of trade, a measure of its purchasing power (the ratio of export prices to import prices) being kept low, rather than being improved (Watanabe [2025]).

253 Watanabe (2025)

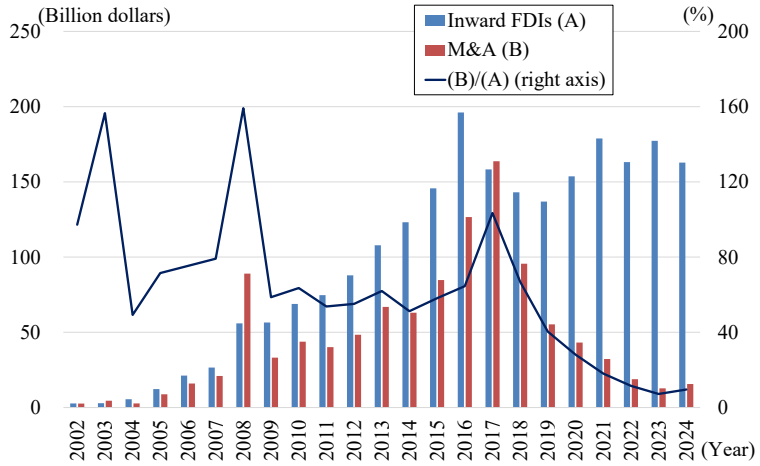
Figure II-2-4-5. Changes in Chinese outward FDIs



Note: The data on outward FDIs excludes the financial sector up to 2005.

Source: Ministry of Commerce of China, CEIC.

Figure II-2-4-6. Changes in Chinese outward FDIs and M&A



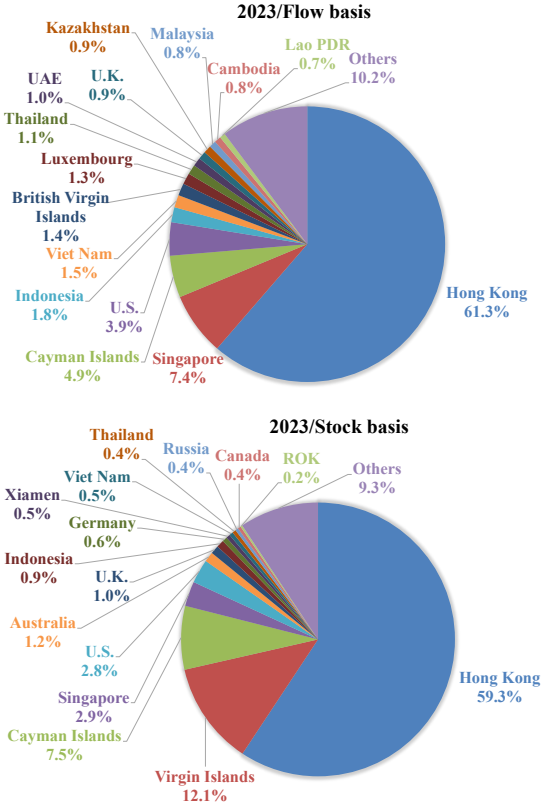
Note: The data on M&As are compiled by extracting China's cross-border M&As (outward M&As) derived from the data on M&As recorded in the LSEG database. See the footnotes for details.[254]

Source: Ministry of Commerce of China, CEIC, LSEG.

[254] Specifically , this figure shows the aggregation of M&As in which the nationality of the acquiring company (or the ultimate parent company, if exists) is China, and that of the target company is outside of China. The data was extracted as of November 8, 2024, and is compiled based on the calendar year of the transaction's completion date. M&As for which the acquisition amount is not disclosed are ultimately excluded from the aggregation. Note that the statistical definitions and coverage are not fully aligned between the two datasets. These M&A statistics are classified based on the nationality of the ultimate parent company. Therefore, if a subsidiary located in a third country carries out the acquisition as an acquiring company, the transaction is still counted as a Chinese M&A in these statistics. However, in conventional FDI statistics, such a case would be considered to be the one by the third country and not considered Chinese FDI. For convenience, the ratio of M&A to outward FDI is calculated by dividing the aggregated M&A value by the outward FDI amount published by the Ministry of Commerce of China. In the early 2000s, the number of M&As was small, resulting in large fluctuations in the figures. Note that the statistics for China refer to mainland China only and do not include Hong Kong.

According to the breakdown of outward FDIs from China by recipient countries, investments in Hong Kong account for around 60% of overall investments both on a flow basis and on a stock basis. Combined investments in Hong Kong and tax havens, such as the Cayman Islands and the British Virgin Islands, account for 70 to 80%. Combined investments in Hong Kong, tax havens, and financial centers like Singapore and Luxemburg make up most of the total (Figure II-2-4-7). Presumably, those investment recipient regions are used as conduits for investments in third countries in many cases, but from available data, it is difficult to identify investment flows that go via conduits.[255] As for other countries, on a stock basis, many developed countries, including the United States, Australia, the United Kingdom, Germany, Russia and Canada, were among major investment recipients in 2023. On a flow basis, in addition to the United States and other developed nations, ASEAN countries and many emerging countries located along the One Belt, One Road route, including Indonesia, Viet Nam, Thailand, Kazakhstan, Malaysia, Cambodia, and Laos were among recipients in 2023.

Figure II-2-4-7. Chinese FDIs by major partner country and region (2023)



[255] For example, Hong Kong is used as a conduit for investment in a third country by mainland Chinese investors in some cases (which in effect represent outward FDI from China). However, in other cases, Hong Kong is used as a conduit for investment in mainland China by mainland Chinese investors in order to receive preferential treatment for foreign enterprises (cases of so-called "round-trip investment"), or as a conduit for investment in China and other Asian countries by third-country (non-Chinese) investors. Therefore, it is impossible to grasp the details of the actual state of outward FDI from China based on data on outward FDI from Hong Kong. Recognizing that constraint, here, we will look at investment recipient countries using available data.

Note: The stock-based data are compiled from statistics on major countries published in the China Statistical Yearbook.
Source: Ministry of Commerce of China, *China Statistical Yearbook*, CEIC.

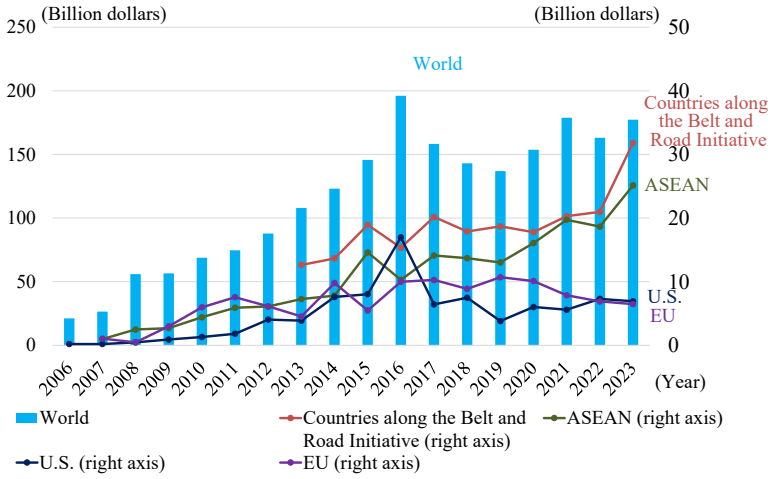
In recent years, Chinese outward FDIs in ASEAN countries, other Asian countries, and countries located along the One Belt, One Road route have increased, while investments in developed countries, including the United States and the EU, have declined or remained flat (Figure II-2-4-8). Regarding the escalation of the trade conflict, it is theoretically possible to assume that the conflict can be mitigated if China makes direct investments in major export destination countries with which it has come into conflict and if the investments lead to increases in local production and employment. However, for the moment, there is no clear sign of China moving to do that.

One background factor cited for the lack of such action is the fact that in the middle of the 2010s, the government of China regarded capital outflows due to excessive investments in non-physical economic sectors, such as real estate, entertainment, and tourism, as a problem and strengthened investment screening.[256] In recent years in particular, outward FDIs from China may have been affected by factors on the side of the United States and Europe, including geopolitical concerns, cautiousness about technology leakage, and moves to strengthen investment screening in light of those risks.[257] Under these circumstances, FDIs made in ASEAN countries and countries along the One Belt, One Road route suggest the possibility that China may be relocating production, among other measures, in order to secure access to resources, low-cost labor, and consumer markets and go around the trade conflict. While those FDIs may help to strengthen political and economic relationships with recipient countries, some Chinese enterprises have caused labor problems in investment recipient countries, so it is necessary to keep close watch as to whether specific benefits may be brought to recipient countries.

[256] Tamai (2020) mentioned the following points: that since the summer of 2015, amid the depreciation of the Chinese yuan, more and more enterprises transferred capital abroad on the pretext of FDI; and that overinvestment in such sectors as real estate, entertainment and tourism caused more and more enterprises to fall into a management crisis. In 2016 in particular, investments in U.S. and European movie theater and hotel businesses, and real estate assets increased.

[257] In the United States, examination by the Committee on Foreign Investment in the United States (CFIUS) was strengthened in 2018 under the Foreign Investment Risk Review Modernization Act. In Europe, concerns about technology leakage to China grew following the acquisition of Kuka, a German machine tool manufacturer, by a Chinese enterprise in 2016. In 2019, the EU FDI Screening Regulation was put into force, and starting in October 2020, it was fully applied (Ministry of Economy, Trade and Industry [2024b]).

Figure II-2-4-8. Changes in Chinese FDIs by region



Note: The values related to the Belt and Road Initiative in this figure are those published since the concept was proposed in 2013. Only the total amount is disclosed here, and it appears to include ASEAN, but, specific countries included have not been disclosed. Furthermore, the data on investments in the financial sector are excluded from 2020 onwards.

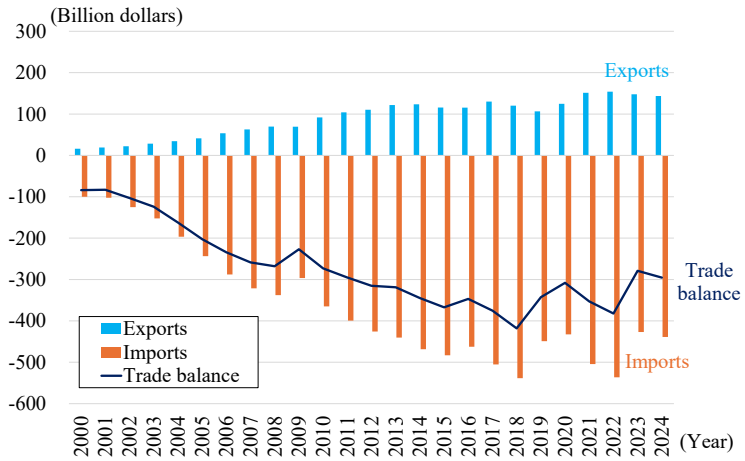
Source: Ministry of Commerce of China, CEIC.

4. Challenges related to Chinese trade and investment

(1) Heightening tensions in trade relationships in recent years

As mentioned earlier, in recent years, increasing exports from China have heightened international tensions. In particular, the United States regards its many years of trade deficit with China as a problem, and this is behind the hardline trade policy that the United States has adopted toward China in recent years. The U.S. trade deficit expanded due to an increase in imports from China, and although the expansion temporarily subsided in 2018, the deficit has remained at a high level since then (Figure II-2-4-9).

Figure II-2-4-9. Changes in trade values between the U.S. and China



Source: Global Trade Atlas.

In this situation, in May 2024, the United States announced that through the revision of tariffs imposed under Section 301 of the Trade Act, it would impose additional tariffs of 100% on Chinese electric vehicles, and additional tariffs of 25% on Chinese steel and aluminum. At that time, President Biden remarked as follows: “China heavily subsidized all these products, pushing Chinese companies to produce far more than the rest of the world can absorb. And then dumping the excess products onto the market at unfairly low prices, driving other manufacturers around the world out of business.” In December of the same year, the United States announced that it would impose an additional tariff of 25% on specified tungsten products and raise the additional tariffs on solar panel wafers and polysilicon to 50%. In the same month, it started a new investigation concerning foundational semiconductors under Section 301.

The EU started an anti-subsidy investigation concerning Chinese battery electric vehicles in October 2023. As a reason for that action, European Commission President von der Leyen explained that the presence of overcapacity in China was evident, with surplus production flowing over to other countries as exports, and that this trend was strengthening due to direct and indirect subsidies provided by the government of China and was distorting the market. In July 2024, the imposition of provisional tariffs started, and in October, the European Commission published a final report and made a final decision to impose countervailing duties of up to around 35%.

There are concerns about increases in exports from China in countries other than the United States and European countries as well. In addition, the trade conflicts between China and the United States and between China and European countries may have an impact on third countries too. That is because Chinese products excluded from the U.S. and European markets through the abovementioned trade measures may flow to third countries, including other Asian countries and emerging countries, resulting in export upsurges.

One piece of data evidence suggesting that possibility is an uptrend in the number of trade remedy measures taken against Chinese products. The countries and regions that have launched the largest numbers of anti-dumping investigations since 2020 are India, the United States and the EU. In 2024, the numbers of investigations launched by Brazil, Colombia and Turkey rose. By industry, the base metal industry (e.g., steel and aluminum) was the industry in which the largest number of anti-dumping investigations has been launched since 2020, followed by the chemicals industry and the machinery industries, including wind power towers. As for anti-subsidy investigations, the countries and regions that have launched the largest numbers of investigations since 2020 are the United States, Australia, Canada and the EU, and Brazil and India have also resorted to anti-subsidy investigation. By industry, since 2020, the base metal industry (e.g., steel and aluminum) was the industry in which the largest number of investigations has been launched, followed by machinery industries.

In order to ease the tensions in trade relationships, it is important to ensure transparency over trade and industrial policies, foster international trust, and promote constructive efforts to ensure fair competitive conditions. Below, we will point out major challenges in those respects. Regarding the details of the relationships between specific problems and the WTO Agreements, explanations are provided in the Report on Compliance by Major Trading Partners with Trade Agreements, published annually by the Subcommittee on Unfair Trade Policies and Measures of the Industrial Structure Council.

(2) Lack of transparency over policies and policy support

It has been pointed out that in China, there are laws, regulations and guidance documents that have not been made public, and in some cases, the texts of promulgated laws and regulations are so abstract that there is a lack of transparency over the specifics of regulations, although some improvements have been made in recent years.[258] It has also been mentioned that notifications regarding subsidies required under the WTO are insufficient. In the 2024 edition of the Trade Policy Review report concerning China, the WTO Secretariat observed that it is impossible to clearly identify the overall picture of governmental financial support and other incentives for various sectors and industries and fiscal support including government guidance funds and pointed out that this lack of transparency is also affecting debates on "overcapacity."[259]

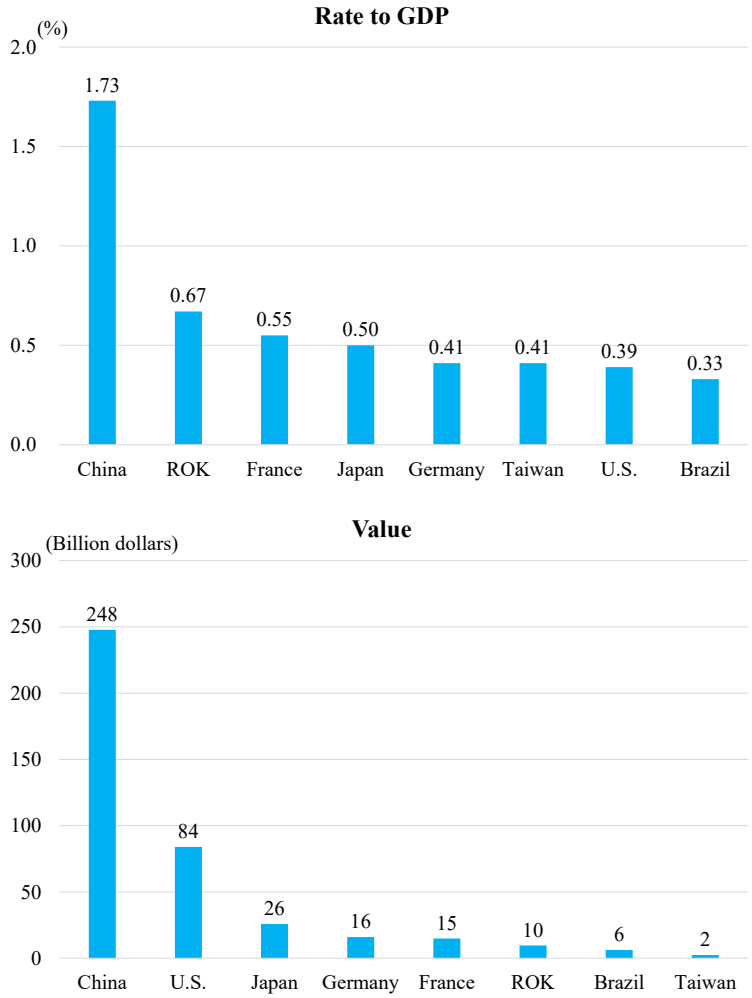
In addition, regarding economic statistics prepared by the government of China, problems such as the failure to publish necessary detailed data and the suspension of publication of some statistics make it difficult to more accurately identify the overall picture of the Chinese economy, and this is one of the factors that deepen the lack of transparency. The stagnant personnel exchange, including in business and academic circles, due to the recent deterioration of the business environment may also impede the appropriate understanding of and common perspectives on China's policies and economic situation.

(3) Budgetary size of industrial policies

In recent years, China has expanded subsidy expenditures for priority industries, and the low level of transparency over those expenditures has been pointed out.[260] Therefore, let us compare major countries in terms of the size of governmental support provided under industrial policies based on estimations made by Dipippo et al.[261] According to the estimations, expenditures on industrial policies by China are very large compared with expenditures by other major countries. As a proportion of GDP, expenditures by Japan, the United States, and major European countries roughly range between 0.4% and 0.6%, while expenditures by China are 1.73%, or around three to four times as large (Figure II-2-4-10). In terms of absolute value, the difference is even larger. Expenditures by China are three times as large as expenditures by the United States, the second largest spender, and 10 times as large as expenditures by Japan. As for the mix of industrial policies, in China's case, loans with interest rates lower than market rates, subsidies and preferential tax measures (excluding those related to research and development) account for large portions of overall expenditures on industrial policies (Figure II-2-4-11). The low level of transparency over subsidy expenditures tends to encourage the provision of subsidies that have market-distorting effects, so there is suspicion that it is contributing to the overcapacity problem in sectors such as steel and aluminum. This is an important challenge that could have a negative impact on the industrial development of other developing countries, too.

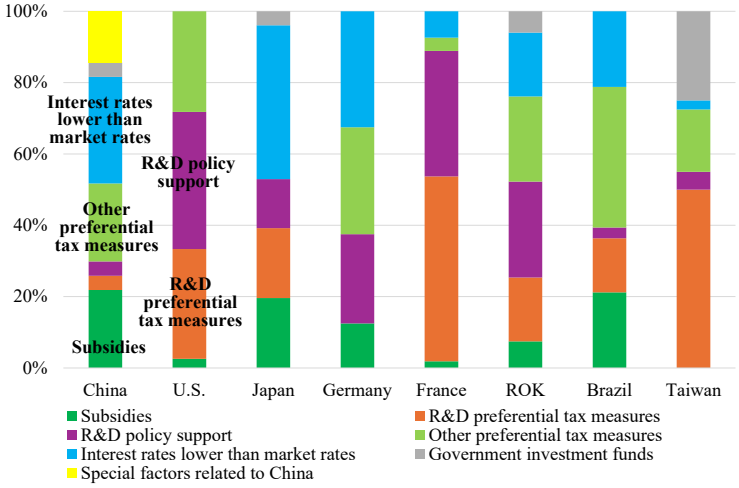
258 Ministry of Economy, Trade and Industry (2024a)
259 WTO (2024)
260 Ministry of Economy, Trade and Industry (2024a)
261 Dipippo et al. (2022)

Figure II-2-4-10. Expenditures by industrial policies by major country and region



Source: Dipippo et al. (2022).

Figure II-2-4-11. Compositions of expenditures by industrial policy by major country and region



Source: Dipippo et al. (2022).

(4) Issues related to state-owned enterprises

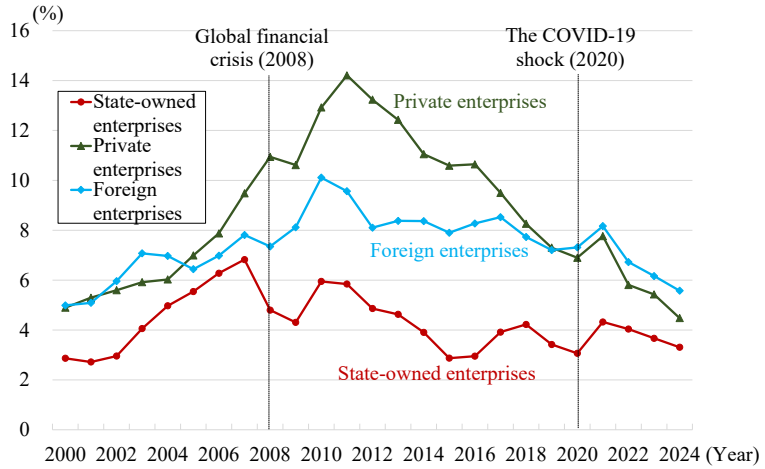
One issue that often comes up from the viewpoint of competitive neutrality is the treatment of state-owned enterprises (SOEs). Since the adoption of the reform and opening-up initiative, the reform of SOEs has been carried out against the backdrop of their low efficiency (Figure II-2-4-12). In the late 1990s, the policy of allowing SOEs to exist only in public goods sectors was advocated, so privatization made progress, mainly among inefficient small and medium-size enterprises (Table II-2-4-13). As a result, as described in Part II, Chapter 2, Section 1, the share of SOEs has been declining. In the middle of the 2000s, due to a policy change, the scope of SOEs was expanded.[262] Starting in the middle of the 2010s. it was prescribed that SOEs would continue to exist not only in public-interest sectors but also in commercial sectors, so the reform moved in a direction different from the previous vision of privatization. Under a mixed ownership system, the ownership of shares in some SOEs was opened to the private sector, and China advocated the policy of using the knowledge of private enterprises for the management of SOEs. It has been mentioned that China shifted to the policy of fostering SOEs that are competitive in global markets, as shown by the slogan "Bigger, better, and stronger." The strengthening of the party's leadership was also advocated.

On the other hand, although the presence of private enterprises was recognized and those enterprises developed after the launch of the reform and opening-up initiative, their importance declined relatively in a trend known as "the state sector advances as the private sector retreats," due to the reappraisal of the importance of SOEs in the middle of the 2000s and later. Although investment in SOEs was allowed under the mixed ownership system, it has been pointed out that in most cases, the ratio of investment by the private sector has been kept low and control by state capital has been maintained.[263] Conversely, some private enterprises turned themselves into SOEs by accepting investment from state capital. Moreover, in the 2020s, governmental regulations on some industries, such as education and IT platform business, have been strengthened, and this, coupled with the real estate slump, put private enterprises in a severe situation.

In order to address concerns about the competitive neutrality of SOEs, it is important to make efforts such as ensuring transparency over information concerning SOEs, clarifying the objectives of, and the scope of authorities that can be exercised by, state capital, and creating a system to ensure actions based on commercial considerations.

[262] Kato, Watanabe and Ohashi (2013)
[263] Kwan (2019)

Figure II-2-4-12. Changes in return on assets by enterprise type in China (industrial sector)



Notes:

1: The following formula is used: Return on Assets = profit / total assets.

2. The term "Industry" includes the mining, manufacturing and electricity, gas and water industries.

Source: National Bureau of Statistics of China, CEIC.

Table II-2-4-13. Major policies for state-owned enterprises in China

Year	Policies, etc. for state-owned enterprises
1997	15th National Congress of the Communist Party: "Strategic Reorganization of State-Owned Enterprises" - Maintaining state ownership only in certain industries that provide public goods Withdrawing state-owned enterprises from sectors where they compete with non-state-owned enterprises
From late 1990s	Privatizing state-owned enterprises, mainly SMEs
2003	Establishing the State-owned Assets Supervision and Administration Commission (SASAC) - Promoting mergers among large state-owned enterprises
2005	"Opinions of the State Council on Deepening the Reform of the Economic System in 2005" - Retaining state-owned capital
2006	"Guiding Opinions of the SASAC about Promoting the Adjustment of State-owned Capital and the Reorganization of State-owned Enterprises" - Expanding the scope of industries where state-owned capital should be invested (industries related to critical infrastructure and critical mineral resources)
2006	SASAC Chairman Li Rongrong's announcement - Industries where the state-owned economy should hold absolute control (7 industries) and those where it should hold relative control (9 industries)
2012	18th National Congress of the Communist Party: Inauguration of the Xi Jinping administration
2013	Third Plenary Session of the 18th Central Committee: "Decision of the CCCPC on Some Major Issues Concerning Comprehensively Deepening the Reform" - Driving the market to play a decisive role in resource allocation - Advancing the mixed-ownership economy
2015	The CPC Central Committee and the State Council: "Guiding Opinions on Deepening the Reform of State-Owned Enterprises" - Advancing state-owned enterprise reform by category (commercial and public welfare sectors), developing modern corporate systems and the mixed-ownership economy, preventing the outflow of state assets, and strengthening the leadership of the Communist Party - Strengthening state-owned enterprises as the goal of state-owned enterprise reform Upholding the policy of "Bigger, better, and stronger"
2020	The Central Commission for Deepening Overall Reform: "Three-Year Action Plan for the Reform of State-Owned Enterprises (2020-2022)" - Stating such measures as advancing the listing of state-owned enterprises and introducing private capital to participate in governance through deepening the mixed-ownership reform

Source: *White Paper on International Economy and Trade 2022* (compiled by METI based on various data)

(5) Insourcing/preferential treatment of domestic products

In China in recent years, there have been moves to give preferential treatment to domestic industries in terms of government procurement, regulations, and standards or to impose excessive burdens on foreign enterprises, thereby dampening investment appetite, and those moves have raised concerns about the business environment in China.

(A) Government procurement

Regarding government procurement, when it acceded to the WTO, China pledged to accede to the WTO Agreement on Government Procurement in the future (the accession negotiation is still ongoing), to ensure transparency over the government procurement procedures, and to provide non-discriminatory treatment when procuring from abroad. On the other hand, under the Chinese Government Procurement Law (put into force in January 2003), the government is required to procure domestic products. In 2021, there was a media report that the Ministry of Finance and the Ministry of Industry and Information Technology of China issued confidential internal notifications prescribing the domestic procurement rates regarding 315 items in 41 categories to local government bureaus under their jurisdictions and gave instructions for preferential purchases of domestic products. Therefore, it is necessary to pay attention as to whether or not imports are in effect excluded from government procurement. Under the Foreign Investment Law (put into force in January 2020) and the regulations for implementing the law, China prescribed that in government procurement, products and services produced by foreign investment enterprises in China are given equal treatment with domestic products and services. However, it has been pointed out that under the "secure and controllable" system, and the "innovation on informatization and application" system, which were put into force in 2019, products made by foreign enterprises, including both imports and locally-made products, are given unfavorable treatment because of the "secure and controllable list" and the "innovation on informatization and application list," which designate enterprises and products recommended for government procurement. In December 2023, the government procurement standards concerning computers and other products were published for reasons of information security, and as a result, products made by foreign enterprises have been excluded from bids.[264] Since then, the lack of transparency over how products and services from foreign enterprises will be treated has undermined predictability for businesses. Therefore, in a white paper in 2024, the Japanese Chamber of Commerce and Industry in China requested the establishment of an environment in which domestic and foreign enterprises can participate in market competition in government procurement on an equal footing.[265]

(B) Standards and certification

Under the regulation of cosmetics in China, new materials are required to be registered with the authorities. However, it has been pointed out that there have been few actual cases of registration and that in some cases, it is technically difficult to submit required documents, or the disclosure of trade secrets concerning manufacturing processes is required. Even now, there remain problems such as the restriction on internationally recognized testing methods, although some improvements have been made.

[264] Ministry of Economy, Trade and Industry (2024a)
[265] The Japanese Chamber of Commerce and Industry in China (2024)

There was also information indicating that the recommended national standards concerning office equipment would require development and production in China. Draft standards for public comment, published in August 2023, did not include that requirement. However, if the requirement had been included and enforced as an effectively binding rule, it might have impeded imports of finished products and parts.[266] In addition, the so-called three data laws, the Cybersecurity Law, the Data Security Law, and the Personal Information Protection Law, may be more trade-restrictive than necessary due to a lack of clarity over their specifics and could also entail additional cost necessary for domestic data storage or impede smooth business activity using data. There are concerns that in the name of protecting data, those laws could put foreign enterprises at a disadvantage.[267]

(6) Intellectual property

Although the legal system concerning intellectual property has gradually been developed, sufficient improvements have not yet been made, with counterfeit and pirated products continuing to infringe intellectual property rights. In recent years, there have been voices of concern about the risk of intellectual property leaking out through standards and certification regulations. As already mentioned, regarding the regulation of cosmetics in China, concerns have been expressed about the risk of trade secrets concerning manufacturing processes leaking out. With respect to the recommended national standards concerning office equipment, there were concerns that depending on practical enforcement, foreign enterprises might be forced to provide technology to the Chinese side if they were to conduct development and production activities in China, leading to effective transfer of technology, although the draft standards for public comment did not include a requirement to that effect.

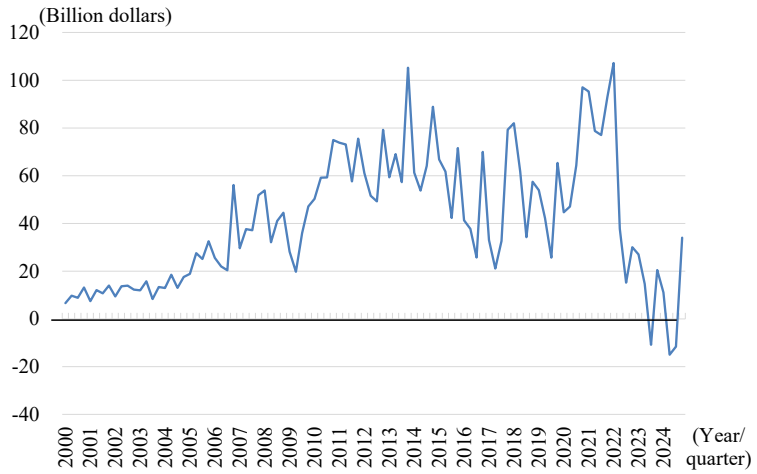
5. Business developments and voices from the business world

(1) Decrease in inward FDIs

In this situation, in the July-September quarter of 2023, the value of inward FDIs in China fell into the negative column (net outflows) for the first time since 1998, the earliest year for which the current form of statistics is available (Figure II-2-4-14). Withdrawals and retrievals may have outpaced new investments. Although the value of FDIs temporarily returned to the positive column in the October-December quarter of 2023, it slipped into the negative column again in the April-June quarter of 2024 and remained there in the July-September quarter. This trend attracted attention as evidence of a decline of foreign enterprises' eagerness to invest in China. Presumably, behind the trend are not only the economic stagnation in China but also developments that run counter to a fair business environment, such as a lack of transparency of the government of China's policies and the concerns about government procurement and transfer of technology.

[266] Ministry of Economy, Trade and Industry (2024a)
[267] Ministry of Economy, Trade and Industry (2024a)

Figure II-2-4-14. Changes in Chinese inward FDIs (international balance of payments basis)



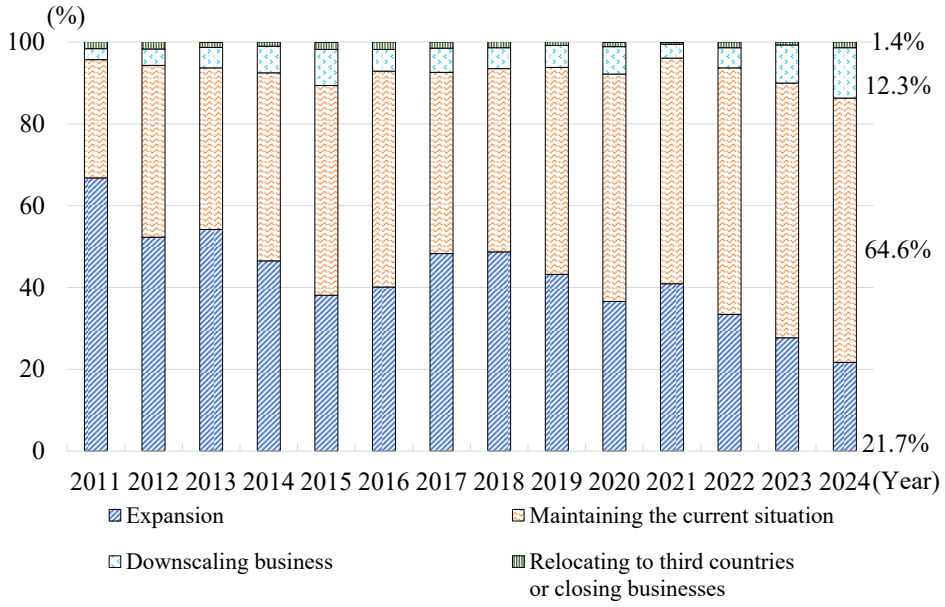
Source: State Administration of Foreign Exchange of China, CEIC.

(2) Evaluation by local subsidiaries of Japanese, U.S. and European enterprises

From a long-term perspective, although China at first implemented preferential measures for foreign enterprises in anticipation of technology transfers, it gradually shifted to a selective approach, limiting the scope of support to specific industries designated for promotion. As competition intensified due to the growth of Chinese enterprises, the business situation in China became more and more difficult. In recent years, there have been developments that dampened foreign enterprises' investment appetite, as already mentioned.

We will consider what local subsidiaries of foreign enterprises plan to do with their business in China in response to those developments. Every year, JETRO conducts a questionnaire survey with local subsidiaries of Japanese enterprises, which includes questions concerning the future direction of business. According to the survey, in recent years, the ratio of enterprises planning business expansion in China has declined. In the 2024 survey, the ratio fell to a new record low of around 20% (Figure II-2-4-15). Even so, two-thirds of the respondents were planning to keep their business operations in China unchanged, while only around 10% were planning reduction and around 1% were planning relocation to a third country or withdrawal from China. The finding indicates that Japanese enterprises still regard China as an important business base.

Figure II-2-4-15. Direction of business development for the next 1-2 years (Japanese companies in China/All industries)



Source: *Survey on Business Conditions of Japanese-Affiliated Companies Overseas (annual editions)* (JETRO).

Meanwhile, the Japanese Chamber of Commerce and Industry in China, comprised of Chinese subsidiaries of Japanese enterprises, summarizes proposals for resolving challenges faced by Japanese companies in a white paper every year. In the latest 2024 edition of the white paper, the organization called for "securing business opportunities by improving non-discriminatory status, predictability and transparency" as an overall concept.[268] Under that concept, its requests to China were summarized into three items: "fair competition," "opening up to the international community," and "improvement and facilitation of administrative predictability and transparency" (Table II-2-4-16). As for the main specifics, regarding "fair competition," the organization called for fair competition for imports and domestic products, the clarification of the "secure and controllable" system and the "innovation on informatization and application" system, as mentioned in the paragraph concerning government procurement. Regarding "opening up to the international community," it requested further regulatory relaxation in sectors where entry by foreign enterprises is prohibited (the special control measure concerning foreign investment access [negative list]). Regarding "improvement and facilitation of administrative predictability and transparency," the organization requested the resumption of visa exemption, the shortening of the examination period, the unification of interpretation and enforcement of customs rules and regulations, and consideration for enterprises in the enactment and operation of

[268] JETRO "CHUUGOKU NIHON SHOUKAI 2024 NEN HAKUSHO, JINTEKI KOURYUU YA DEETA ITEN, SEIFU CHOUTATSU WO KENGI," Business Tanshin, July 11, 2024, https://www.jetro.go.jp/biznews/2024/07/47d95d45086e14a3.html; The Japanese Chamber Commerce and Industry in China (2024)

laws and regulations related to the Cybersecurity Law of China, which was mentioned in the paragraph concerning standards and certification.

Table II-2-4-16. Major proposals by the Japanese Chamber of Commerce and Industry in China (Jul. 2024)

Overall concept

Securing business opportunities by improving non-discriminatory status, predictability and transparency

1. Fair competition
 - Improving the treatment of imported products in the government procurement market and achieving fair competition between imported and domestic products,
 - Clarification of the "secure and controllable" or "innovation on informatization and application" systems and disclosure of information on certified products, etc.

2. Opening up to the international community
 - Further relaxation of the Special Management Measures on the Entry of Foreign Investment (Negative List),
 - Relaxation of entry restrictions by laws and regulations other than the negative list, etc.

3. Improvement and facilitation of administrative predictability and transparency
 - Resumption of visa waiver measures as soon as possible, and shortening of visa examination period,
 - Consideration for user companies in the enactment and operation of China Cybersecurity Law and related regulations, etc.

Source: The Japanese Chamber of Commerce and Industry in China (2024).

Those requests do not reflect uniquely Japanese concerns but have commonalities with requests from other major countries. For example, the 2024/2025 edition of the European Union Chamber of Commerce in China's letter of requests mentioned requests in six sectors, including "market access and procurement" (Table II-2-4-17). The EU Chamber of Commerce in China called for the clarification of the criteria for "made in China" and the development of a fair competitive environment in government procurement, just as the Japanese Chamber of Commerce and Industry in China did. Regarding digital technology, the organization requested that care be taken to prevent data transfers from impeding the conduct of business and with respect to the protection of intellectual property, it pointed out that problems remained with respect to the enforcement of relevant laws and regulations despite continuing improvements.

Table II-2-4-17. Major proposals by the European Union Chamber of Commerce in China (Sep. 2024)

1. Market access and procurement Requiring the revision of the Government Procurement Law and the clarification of the standards for "Made-in-China" products as well as requesting greater market access and a level playing field for foreign companies in public procurement
2. Human resources and business visit Requesting prompt action regarding the phased visa exemption implemented in China to include for EU member states that have not yet been granted this exemption
3. Digital field and cyber networks Requesting the clarification of the scope of "important data" and "sensitive personal information" and the relaxation of overly strict regulations regarding cross-border data transfers
4. Access to green energy Requesting guidance for local governments, access to green power, improvements to trading systems, improvements of storage and transmission infrastructure, etc.
5. Intellectual property rights Pointing out many challenges in the enforcement of laws and regulations while recognizing the well-established system thereof, and requesting the enhancement of the capabilities of local authorities and the improvement of certain sectors, such as medical devices, pharmaceuticals, and clothing and leather products
6. Investment promotion and facilitation Seeking a bilateral exchange of views in the dialogue with the Chinese government and requesting clarification on the specifics of the support measures available to foreign companies

Source: *CHUUGOKU EU SHOUKAI NO TEIGENSHO, SHIJOU AKUSESU KAIZEN YA BIZA MENJO KAKUDAI WO YOUBOU* (Business Tanshin on September 17, 2024) (JETRO) (https://www.jetro.go.jp/biznews/2024/09/098f7f8380670ffb.html), The European Union Chamber of Commerce (2024).

Meanwhile, the American Chamber of Commerce in China pointed to the importance of promoting high-level communication and called for equal treatment for all enterprises regardless of the investment type, improvement of transparency over subsidies, business-oriented policies and regulatory reforms, a flexible approach to cross-border data transfers, and the realization of efficient and equal market access for foreign investment enterprises (Table II-2-4-18).

Table II-2-4-18. Major proposals by the American Chamber of Commerce in China (Apr. 2024)

1. Promoting high-level communication and dialogue between the U.S. and China to foster sustained mutual understanding between the two countries
   - Separating economic issues from national security concerns to the greatest extent possible, and limiting the targets of export control regulations and investment management while understanding the need thereof
   - Holding multiple high-level bilateral forums in 2024

2. Formulating clear and consistent policies and ensuring the implementation thereof so as to enable enterprises to make investment decisions based on sufficient information
   - Treating all enterprises equally, regardless of their form of investment
   - Promoting the business-oriented policies and regulatory reforms led by the Chinese government from the viewpoint of enhancing transparency in subsidies and other sectors
   - Adopting a flexible approach to cross-border data flows to address excessive regulations that may hinder effective data transfer and global business operations

3. Ensuring efficient and fair market access to maintain the engagement of foreign-invested enterprises in the Chinese market
   - Reducing biased research into the business activities of foreign companies and interference with internationally recognized due diligence processes, and ceasing arbitrary import restrictions on non-sensitive consumer goods imposed as a form of economic coercion

Source: *CHUUGOKU BEIKOKU SHOUKAI, 2024NEN HAKUSHO DE BEICHUU RYOUKOKU NI SOUGO RIKAI NI MUKETA TAIWA SOKUSHIN WO MOTOMERU* (Business Tanshin on May 9, 2024) (https://www.jetro.go.jp/biznews/2024/05/179d67e0286e0d27.html).