

## **Chapter 2 Japan growing with Asia's development - Asia -Pacific framework toward sustainable growth**

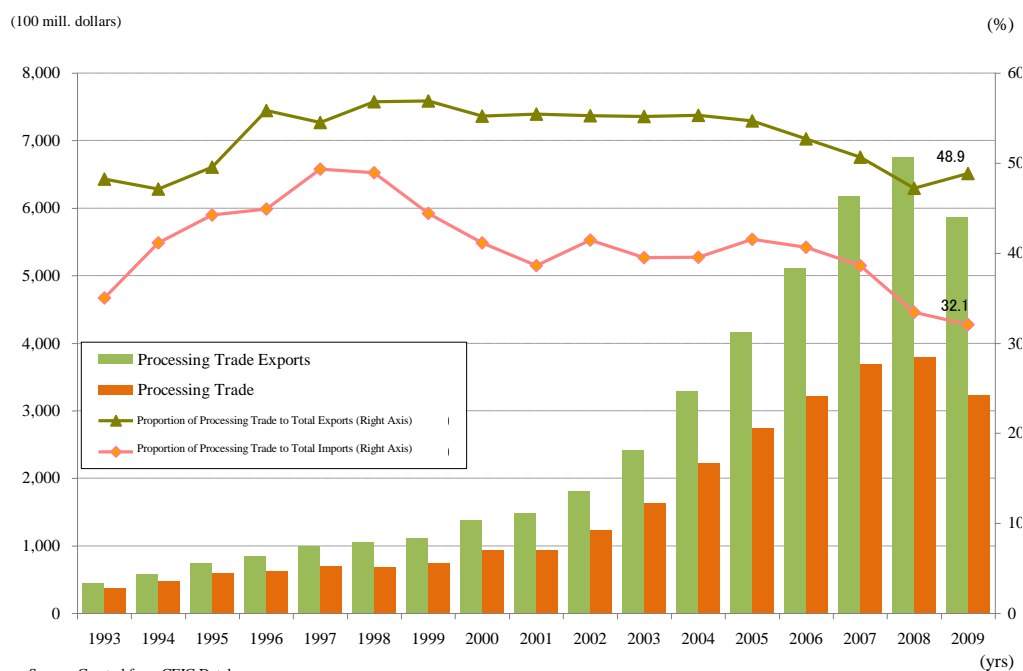
### **Section 2 East Asia: Development from production networks into production/sales network**

#### **5. Changes in the processing trade in world's factory China**

##### **(1) China's trade expansion with processing trade and foreign companies**

In China, triggered by the 1992 southern tour by Deng Xiaoping, the invitation of foreign capital was promoted through various deregulations and preferential tax systems and consequently foreign companies' investment in China rapidly expanded. Moreover, China joined WTO in December 2001 and conducted a large-scale of modification of laws and regulations on foreign companies. It further accelerated investment by foreign companies mainly in the manufacturing industry in China. Based on low-labor cost, foreign companies continued its investment mainly in the area of processing trade that provides preferential treatment such as export tariff exemption. Thus, China's processing trade value enlarged. The ratio of processing trade to the total China's import and export reached about 60% for export and about 50% for import (see Figure 2-2-5-1). The ratio of foreign companies to the total China's import and export increased to about 60% (see Figure 2-2-5-2).

**Figure 2-2-5-1: Changes in total value of China's processing trade**



## **(2) China's processing trade control- the restricted/banned items**

In the light as above, expanding processing trade in China served as the engine for China's economic growth, however, it simultaneously generated some issues such as environment contamination.

Considering this situation, the Chinese government increased the items of which processing trade is restricted or banned<sup>3</sup> and the government also lowered the Export Value-Added Tax Refund Rates<sup>4</sup> in September 2006. In April 2008, "2008 Prohibited Commodity Catalogue for Processing Trading" newly included 39 items as the items of which processing trade is prohibited. The subjects are mainly labor-intensified production items that are the driving force for exports including highly-energy consuming products, highly-contaminating products, resource-related products, textile products, furniture and plastic products.

Meanwhile, lately, concerning the effect from the global financial crisis, the government temporarily suspended the regulations on processing trade and raised some of the Export Value-Added Tax Refund Rates.

## **(3) Changes of China's policy on foreign capital (Shift to tertiary industries)**

China issued a foreign capital policy guideline "the 11th Five-Year Plan for Foreign capital Utilization" in 2006 to achieve the sophistication of industrial structure and the improvement of technology standards as well as the environment conservation and the conservation of resources and energy. It also modified the contents of foreign capital preferential measures. Moreover, in 2007 the government amended "The Catalogue for the Guidance of Foreign Investment Industries" that serves as a guideline to introduce foreign capital aiming to establish sophisticated industrial structure by shifting to highly-technical industries and service industries and to departure from its export promotion policy. In addition, Report on the Work of the Government delivered at State Council in March 2010 announced that "By optimizing the structure to utilize foreign capital, China will encourage foreign investors to invest in high-end manufacturing, high and new technology industry, modern service industry, new energy and energy-saving and environmental protection industry". In the future, it is expected that the Catalogue for the Guidance of Foreign Investment Industries will be modified to focus these areas.

Meanwhile, the companies operating in China will be required to change their business model for example shifting to the value-added goods production and/or expanding sales in the local market. While China receives focus as consumer market, trading companies, retail industry and logistic industry will likely gain attention because of its supporting function of logistics, finance and sales. China is short of management know-how in these areas and it is considered that deregulation for foreign companies will be beneficial to China as well.

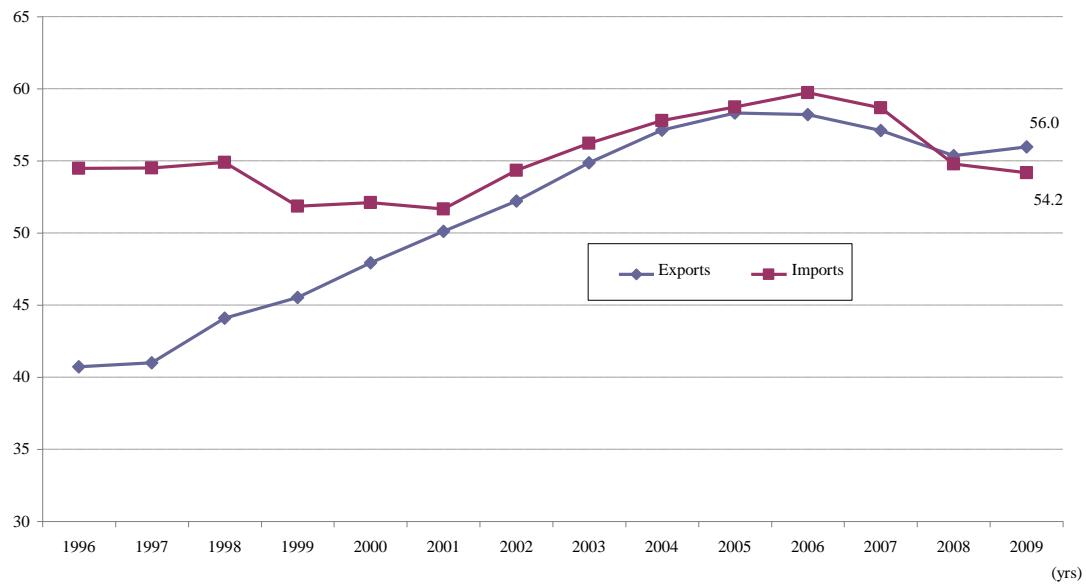
### **Figure 2-2-5-2: Share of foreign companies in total value of China's trade**

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<sup>3</sup> Regarding the items which become the subject of process trade prohibition and restriction, it is possible to trade as general trade items after paying import tariff and Value-Added Tax.

<sup>4</sup> Export Value-Added Tax is value-added tax and its subjects are the commodities for sale. Although an export tax exemption system is employed, actual reimbursement rates are lower than the original export rates. Therefore, the tax exemption is not fully executed.

(%)



Source: Created from CEIC Database.