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- Executive Summary -

Industrial and Regional Policies	**The Benefits to China of Implementing its "Plan for the Development of a Modernized Comprehensive Transport System (2016-2020)" and its Expected Outcomes (Part 2)**

The "Plan for the Development of a Modernized Comprehensive Transport System", which is targeting the construction of a safe, convenient, efficient and eco-friendly modernized comprehensive transport system by 2020, was officially announced and put into action at the end of February this year, more than a year after China's 13th Five-Year Plan (2016-2020) was set underway. This two-part report examines the significance, characteristics and key elements of the Development Plan and offers an overview of the major transport projects in the pipeline, before discussing the expected outcomes of the various policies and the challenges China will need to overcome if its plans for its transport system are to succeed.

News from the China Advisory Division	**Fund-raising via investment companies**

The loosening of rules governing foreign exchange administration has increased the number of ways to raise funds using investment companies. This report looks at cases when the subsidiaries of investment companies need to raise funds. It introduces some administrative points to consider when examining which fund-raising scheme to adopt.

The Benefits to China of Implementing its "Plan for the Development of a Modernized Comprehensive Transport System (2016-2020)" and its Expected Outcomes (Part 2)

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Expectations for both more cost-effective passenger and freight transport and economic growth and structural change in the national economy, and the challenges to achieving them

4. Efforts to develop smart, green transportation towards environmental protection and resource conservation and where China is focusing its attention

The priority projects detailed in the first half of the Development Plan that was discussed in Part 1 of this report are relatively traditional and general, whilst the content dealt with in the second half focuses more on the development of modern, sophisticated industrial technologies, and addresses the issues of market demand and regional strategy.

The most transformative and noteworthy aspect of the Development Plan is the decision to orient policy towards global trends in the development of Industry 4.0 and the Internet of Things (IoT). The six priority projects for developing smart transportation that are presented in the upper half of **Table 7**, specifically: (1) Inter-networking of high-speed railways and commercial aircraft via the Internet; (2) Sharing / open sourcing of transport data; (3) Joint operation of comprehensive transport hubs and development of a service model; (4) Development of a model for a new-generation, nationwide traffic control network; (5) Expanded ETC application on expressways; and (6) Expanded use of the BeiDou Navigation Satellite System, predominantly draw on developments in information and communication technology (ICT). Of particular note is the project targeting the sharing / open sourcing of road transport data, the aim of which is to promote the use of big data, and the efforts to promote widespread use of the BeiDou Navigation Satellite System, which has been developed using unique Chinese technology, both of which will help China meet its transportation and logistical needs, streamline traffic management, and improve inter-industry and inter-regional data sharing and data use standards, and argue that China will establish key security infrastructure necessary to promoting the development and application of local technology.

The Development Plan also emphasizes the importance of building green transport systems, and sets forth policy goals (Part 1, bottom half of Table 2) and key projects (bottom half of **Table 7** "Priority Projects for Developing Green Transportation") towards this end. The four key projects named here, specifically: (1) Transport energy saving and emissions reduction project; (2) Green transport equipment development project; (3) Transport resource-saving project; and (4) Transport ecology and environmental protection project, are all critical to the implementation of environmental protection measures, and have been positioned as a priority in key river basins and regions suffering significant air pollution.

Table 7: Priority Promotion projects for Developing Smart, Green Transportation given in the Development Plan

[Priority Projects for Developing Smart Transportation]
(1) Inter-networking of high-speed railways and commercial aircraft via the Internet ・ Select high-speed rail links for a model experiment, use public mobile communications networks and wireless high-speed broadband to provide onboard Internet service, select commercial aircraft for a domestic experiment and provide inflight Internet connectivity.
(2) Sharing / open sourcing of transport data ・ Build a center for comprehensive transportation big data and promote construction of platforms for open sourcing and sharing of transport data. Strengthen public information platform service functions for national transportation and logistics, focus on promoting the open sourcing and sharing of transportation and logistics data across various means of transport, regions and national borders.
(3) Joint operation of comprehensive transport hubs and development of a service model ・ Develop a model for joint operation and service provision for comprehensive transport hubs in the Beijing-Tianjin-Hebei and the Yangtze Economic Belt, build data sharing platforms and platforms to support decisions on emergency coordination and cooperative supervision, work towards the realization of dynamic organization and flexible arrangement of urban public transport and external transport systems.
(4) Development of a model for a new-generation, nationwide traffic control network ・ Select road spacing and major cities and develop models for intelligent control of public transport, intelligent cooperation between service vehicles, and driver assistance systems; utilize high-precision positioning, cutting-edge sensing, smartphone internet, and smart control technologies; make transport supervision, transport systems, operation and management, safety and emergency, and roadway cooperation more intelligent.
(5) Expanded ETC application on expressways ・ Improve ECT coverage on expressways nationwide. Install ECT systems and make payment easier; improve the efficiency of tourist transportation and green taxi operations. Explore non-stop payment options for standard box trucks (freight vehicles). Enhance service support for tourists and province-level Internet payment centers; construct highly efficient billing systems; aim to achieve widespread use of ECT systems on roads, urban public transportation, taxis, parked vehicles, and road-based tourist transportation.
(6) Expanded use of the BeiDou Navigation Satellite System ・ Accelerate application of the BeiDou System at general aviation aerodromes, for monitoring flight operations, maritime emergency rescue operations, and onboard navigation, etc. Use all weather, round-the-clock, high-precision positioning, guidance, and timing services to enhance basic support for road vehicles, shipping vessels and automated driving systems. Encourage auto manufacturers to mount BeiDou terminals; promote efforts to ensure that the BeiDou module becomes the standard application for vehicle navigation and smartphones; explore BeiDou usage in railway traffic control, port management, and the management and supervision of road vehicles and shipping vessels.
[Priority Projects for Developing Green Transportation]
(1) Transport energy saving and emissions reduction project ・ Provide support for the planning and construction of charging stations and gas charging stands in expressway service areas, and gas charging stands and other ancillary equipment on the mainstream of the Yangtze and the Xijiang and along the Beijing-Hangzhou Grand Canal. ・ Promote the recovery and disposal of oil and gas at quay berths handling crude oil and petroleum products; encourage vessels to use coastal power when in port. ・ Develop pollutant prevention measures for shipping vessels in the big three regions of Beijing-Tianjin-Hebei, the Yangtze Delta and the Pearl River Delta; reduce annual sulfur oxide, nitrous oxide, and particulate pollutant emissions to 65%, 20% and 30%, respectively of their 2015 levels by 2020.
(2) Green transport equipment development project ・ Accelerate efforts to promote the use of natural gas-powered transport equipment and loading and unloading equipment, electric cars and hybrid vehicles; encourage widespread use of direct current – alternating current engines on railroads; phase out diesel engines sequentially. Accelerate the phasing out of aging passenger ships and vessels carrying hazardous freight on the Yangtze and other major rivers.
(3) Transport resource-saving project ・ Improve the efficiency of soil and coastline usage; increase the throughput per unit of quay berths. Actively promote the comprehensive utilization of water resources in road service areas and ports; promote model experiments in resource reuse and recycling in large numbers.
(4) Transport ecology and environmental protection project ・ Build numerous facilities to receive oil-bearing sewage, household sewage, cabin water contaminated by cosmetics, and other waste etc. produced by ports, loading bays, ship repair and shipyards, and shipping

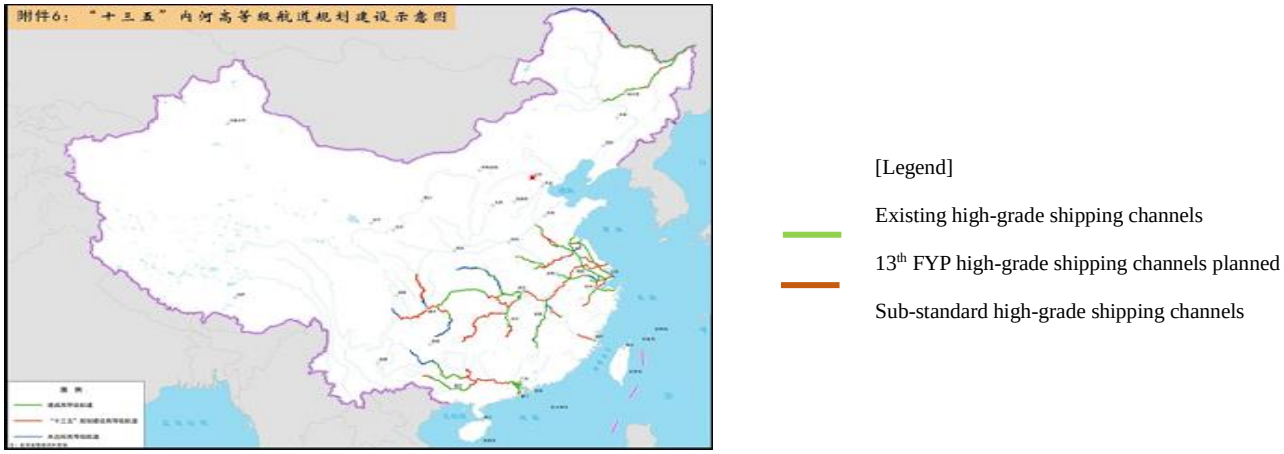
vessels; work towards integration with urban public transport mobile disposal facilities; build numerous sewage treatment and recycling facilities at transport hubs and expressway service areas.

Source: As for Table 2, compiled from the State Council's 13th FYP for the Development of a Modernized Comprehensive Transport System.

Figure 7 shows the current status of and plans for shipping channel construction in major inland waterways, and evidences China's commitment to undertaking projects in the mainstream and tributaries of the Yangtze, the Zhujiang and the Xijiang (Guangdong, Guangxi, etc.), all of which have abundant water resources and extensive deltas, and to promoting construction of high-grade shipping channels in Heilongjiang and Songhuajiang (Heilongjiang Province) in China's northeast. These form part of a transport construction project that is being promoted by China to facilitate the use and conservation of national water resources and the environment, and are clearly beginning to show results. China has been extending its shipping channels and expanding freight transportation on inland waterways since 2010 (**Figure 8**), which is contributing to easing the volume of freight being transported by land and air and to the maintenance and conservation of river environments. Construction, however, has yet to begin on high-grade shipping channels in the Yellow River, China's most important river, or the Beijing-Hangzhou Grand Canal, which is the only Chinese waterway running from north to south, meaning that it has yet to surmount the north-south divide in its water transportation systems.

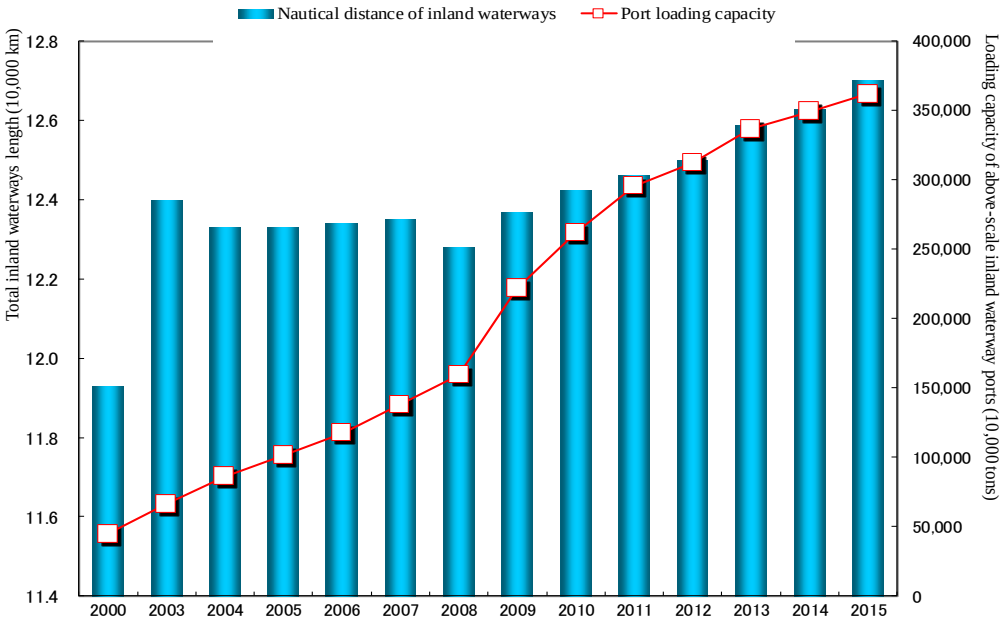
Again, a look at transport pipeline construction projects of oil resources, suggests that, rather than pushing aggressively ahead with these projects in the face of dwindling oil resources and gradually depleting crude stockpiles, China is attempting to expand its infrastructure with an eye towards increased exploration and use of its natural gas resources (exploration and use of shale gas has also risen in recent years). Plans for the construction of natural gas pipelines during the 13th FYP period are more tightly packed than those for either oil or petroleum product pipelines (**Figure 9** and **Figure 10**); moreover, China has already drafted plans in readiness for the natural gas imports that will come as it moves ahead with its "One Belt, One Road" initiative, which argues that consideration is being given to China's energy security in transportation network plans.

Figure 7: High-grade Shipping Channels Planned for Inland Waterways during the 13th FYP Period



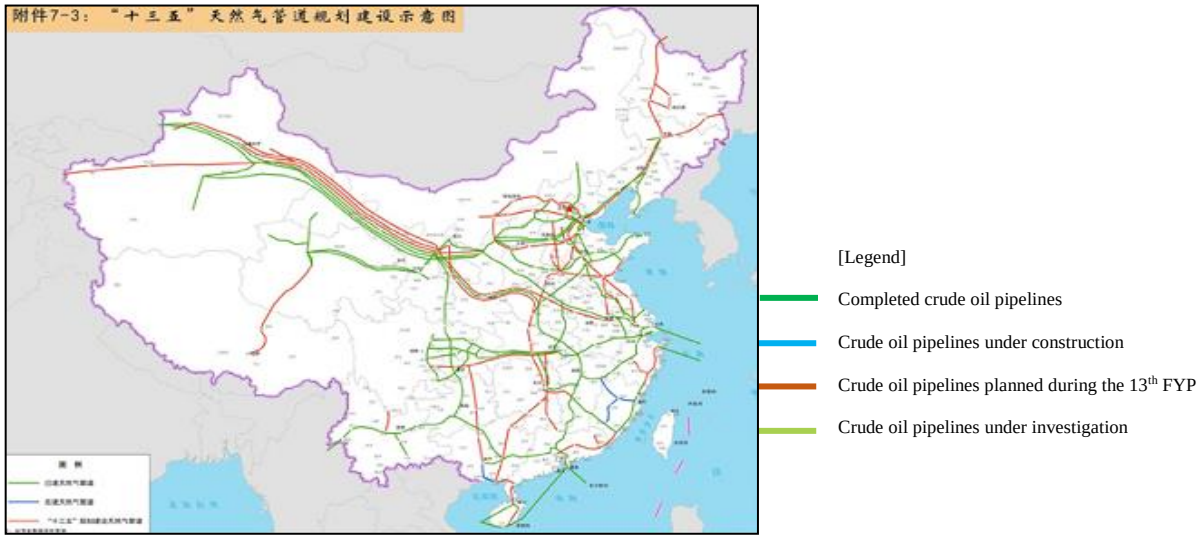
Source: Reprinted from the State Council's 13th FYP for the Development of a Modernized Comprehensive Transport System

Figure 8: Total Inland Waterways Length and Expanded Port Loading Capacity (2000 - 2015)



Source: Compiled from the "China Statistical Yearbook of the Tertiary Industry 2016"

Figure 9: Crude Oil Pipeline Construction Map for the 13th FYP Period



Source: Reprinted from the State Council's 13th FYP for the Development of a Modernized Comprehensive Transport System

Figure 10: Natural Gas Pipeline Construction Map for the 13th FYP Period

Source: Reprinted from the State Council's 13th FYP for the Development of a Modernized Comprehensive Transport System

5. China promoting new sphere projects and comprehensive transport services as a means of achieving industry integration and regional partnerships

In addition to promote the priority projects for smart, green transportation discussed above, the Development Plan presents a list of "Priority Projects in New Spheres of Transportation" (**Table 8, [A]**) and a list of Comprehensive Transport Service Action Plans (**Table 8, [B]**). The list of "Priority Projects in New Spheres of Transportation" comprises six items, specifically: (1) general aviation project; (2) national road port network construction project; (3) mail boat / ferry service project; (4) auto campground construction project; (5) urban transport space development and use project; and (6) pedestrian walkway and cycle path network construction project, suggesting that the policy has been devised with a view to boosting economic development by harnessing the knock-on effects for other industries that these various industries and/or businesses will have in uncovering fresh demand for transportation and meeting people's demand for tourism, leisure and sporting activities. As might be expected, the development of these new sectors is a project for the future, but the realization of a modernized comprehensive transport system argues that there is substantive room for growth in these areas. The Comprehensive Transport Service Action Plans, meanwhile, presents five plans, specifically: (1) a special action plan for continuous passenger travel; (2) a special action plan for continuous multimodal forwarding; (3) a special action plan for standardization of freight trains; (4) a special action plan for the integration of urban and rural transportation; and (5) a special action plan for construction of cities with integrated public transport systems, indicating that China's goal is to achieve an integrated and upgraded transport system by improving transport service quality, removing the disparities between urban and rural transport systems, and building cities with integrated public transport systems. The main text of the Development Plan also calls specifically for enhancements in China's international transportation service capabilities, more cooperation with the countries and regions that line the "One Belt, One Road" route in the area of technical standard, data exchange and information security, and efforts to promote the development of advanced and workable technical equipment[1]. Many of

[1] In the area of rail transport, mention has been made of upgrades in equipment technologies such as high-speed railways, high output electric locomotives, large load freight trains, medium and low speed magnetic linear transport, and research and development on local trains and next-generation high-speed trains; for roads, meanwhile, the plan calls for specialized transport vehicles, box trucks, large and medium-sized limousine buses, safe, practical and economic buses for rural passengers; for waterways, the plan calls for total use of continuous

these goals have already been achieved in the developed countries, but for China with its vast land mass and stark regional disparities between the regions and between urban and rural areas, these initiatives are necessary and, in targeting the accomplishment of these goals within the next five years, China has created an extremely forward-looking action plan for its transport sector.

The presentation of such a wide diversity of priority projects and large number of action plans argues that the Development Plan is extremely comprehensive and modern, and that it was drafted with a strong awareness of the need to develop modern means of transport and information and communications technologies. Its content is fresh and holds expectation for the realization of comprehensive and synergistic development of China's regions and cities, its transport system and industries.

Table 8: Priority Projects in New Spheres of Transportation and Comprehensive Transport Service Action Plans given in the Development Plan

[A] Priority Projects in New Spheres of Transportation
(1) General aviation project ・ Actively develop a short-haul general aviation sector, and encourage regions meeting the necessary criteria to establish general aviation business. Promote passenger air travel industries in regions where conditions are suitable, develop an aviation training sector, and increase the ratio of licensed pilots. Use events such as exhibitions, flying competitions, and aviation culture exchange events to support the growth of general aviation clubs, general aviation aficionado associations, and other corporate groups. Build a cluster of aviation campgrounds, improve flight exercise-related services, and promote flight sports and trial flights.
(2) National road port network construction project ・ Focusing on international and/or nationwide comprehensive transport hubs, build integrated roadside ports with organic links to rail freight stations, ports and airports, etc. Focusing on zonal (regional) comprehensive transport hubs, build base-type roadside ports offering fast links to major transport corridors. Focusing on cities that lie on national expressways, form a wide-area network of station-type roadside ports that provide effective links to the aforementioned integrated and base-type roadside ports.
(3) Mail boat / ferry service project ・ Promote the sequential construction of ports in Tianjin, Dalian, Qinhuangdao, Qingdao, Shanghai, Xiamen, Guangzhou, Shenzhen, Beihai, Sanya, Chongqing and Wuhan, etc., Provide public tourism and private boat services in adjacent seas, rivers and lakes, etc., and enhance ferry boat services for sporting activities.
(4) Auto campground construction project ・ Using focal eco-tourist destinations, ecotourism courses, and national scenic tourist routes as pivots, construct a cluster of integrated auto campgrounds with sleeping accommodation for service automated drivers and house cars, etc.; build functional zones providing auxiliary household services using environment-conserving and energy-saving materials and technologies.
(5) Urban transport space development and use project ・ Establish open zones with integrated urban functions, including transportation, commerce, business, exhibitions, cultural exchange and entertainment, that are anchored by the high-speed rail station terminals, stations for intercity rail passengers and airports at focal international and/or nationwide transport hubs. Plan and build a range of concentrated parking facilities, including parking buildings, underground car parks, and vertical machine-operated car parks, and provide a fixed percentage of electric vehicle charging stations.
(6) Pedestrian walkway and cycle path network construction project ・ Plan and build a system of pedestrian walkways and cycle paths for cities, promote the gradual development of a nationwide network of pedestrian walkways and cycle paths, and build numerous, focal outdoor mountain campgrounds and service stations for users of pedestrian walkways and cycle paths.
[B] Comprehensive Transport Service Action Plans
(1) Special action plan for continuous passenger travel

multimodal forwarding equipment, plus more efficient use of containers and special transport equipment, and the development of large, dedicated transport ships; and for air traffic, the plan calls for the development of large, domestically produced aircraft and dedicated industrial aircraft.

・ Establish a public information platform for community outings to provide passengers with station-by-station information services. Start work on the construction of a system of continuous passenger travel that covers all modes of transport. Realize effect and continuous movement across different modes of transport. Encourage companies to improve their ticketing service systems and make ticketing services more convenient for continuous travel, return journeys and journeys to different regions.
(2) Special action plan for continuous multimodal forwarding ・ Accelerate improvements to the continuous multimodal forwarding services provided by freighting hubs, and accelerate the standardization, construction and refurbishment of shipping units, modes of transport, and loading stations. Accelerate the sharing of information resources relating to continuous multimodal forwarding, encourage innovation in organizational methods, management techniques and core technologies, and cultivate companies to undertake continuous multimodal forwarding operations and take responsibility for organizational capabilities and all transport processes across a range of modes of transport.
(3) Special action plan for standardization of freight trains ・ In line with the principle of "policy guidance, stock liquidation, stricter standards, and a strict ban on volume increases", guide the development of various types of freight trains in accordance with the demands of domestic standards, including technically advanced trucking vehicles, railroad tankers for carrying hazardous liquids, and modular automated trains; straighten out non-statutory conversions and overweight freight trains; promote the creation of a standardized system of freight trains featuring standard types and rational technical specifications; and encourage the widespread use of standardized freight trains.
(4) Special action plan for the integration of urban and rural transportation ・ Select approximately 100 county-level administrative districts and develop a campaign targeting the integration of urban and rural transportation; improve the network of passenger and freighting services in rural areas; provide support for the creation and/or reorganization of a network of passenger and freight spots / stations covering rural areas; encourage innovation in modes of transit for passengers, freight and logistics services in rural areas; and promote widespread use of standardized vehicles for passenger and freight transportation in rural areas, and the harmonized development of passenger and freight transportation in urban and rural areas.
(5) Special action plan for construction of cities with integrated public transport systems ・ Promote the construction of cities with integrated public transport systems across the board in prefecture-level and provincial-level cities; increase the ratio of public transport vehicles powered by renewable energy to at least 35 percent; create networks of dedicated lanes (in principle) for public transport in cities with permanent populations of at least 3 million; consolidate urban public transport resources; encourage the development of new types of services; and improve the efficiency and quality of urban public transport services across the board.

Source: As for Table 2, compiled from the State Council's 13th FYP for the Development of a Modernized Comprehensive Transport System

6. The effectiveness of China's transport policies, the challenges it faces in their implementation and the prospects for the future of transport in China (conclusion)

China has drafted a plan for the development of a comprehensive transport system for implementation during the 13th FYP period, the content and gist of which have been broadly outlined above. To bring the plans to fruition, it will need to beef up its policy support measures in various areas, including better management of plan execution, reinforced policy support, completion of the system governing regulations and standards, stronger innovation in traffic technology, and development of multifaceted personnel teams. Moreover, a list comprising 34 missions has been drawn up in the form of a "Arrangements for the allocation of key missions" so as to expedite the implementation of policy missions and projects, the guidance for each of which has been allotted to multiple government agencies. Some five-to-seven government departments and/or large-scale state-owned transport enterprises have been designated to undertake the management and implementation of the various policy missions and projects, indicating the volume and breadth of the areas regarding transport infrastructure investment, and emphasizing how the

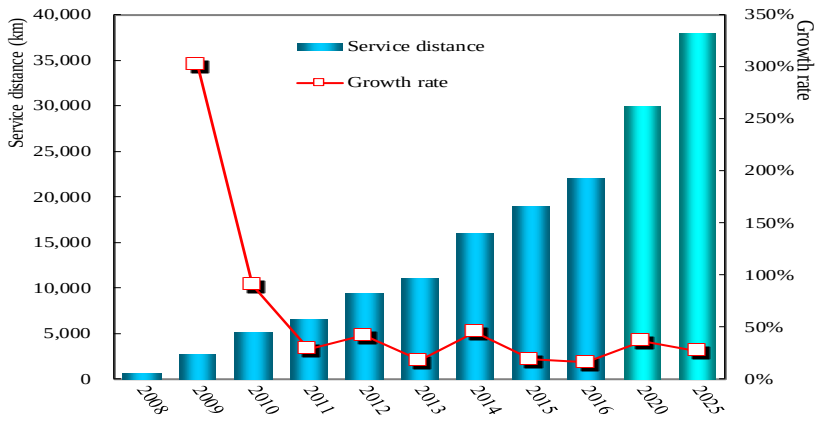
government stresses the importance of development of the transport system within the timeframe of the new FYP. Given China's track record in achieving expanded transport infrastructure development (**Table 9**), and specifically the rapid growth in high-speed railway operation, which have been engineered using original technologies (**Figure 11**), and trends in the development of big data- and IoT-related projects utilizing ICT, the prospects for China's comprehensive transport policy are bright.

Table 9: Trends in Service Distances of Various Transport Routes in China (Unit: 10,000 km)

Fiscal year	Rail lines (total route-km)	National electrified rail lines (total route-km)	Total road length	Total expressway length	Nautical distance of inland waterways	Scheduled domestic flights (total route-km)	Scheduled international flights (total route-km)	Total length of oil and natural gas pipelines
2000	6.87	1.49	167.98	1.63	11.93	150.29	50.84	2.47
2001	7.01	1.69	169.80	1.94	12.15	155.36	51.69	2.76
2002	7.19	1.74	176.52	2.51	12.16	163.77	57.45	2.98
2003	7.30	1.81	180.98	2.97	12.40	174.95	71.53	3.26
2004	7.44	1.86	187.07	3.43	12.33	204.94	89.42	3.82
2005	7.54	1.94	334.52	4.10	12.33	199.85	85.59	4.40
2006	7.71	2.34	345.70	4.53	12.34	211.35	96.62	4.81
2007	7.80	2.40	358.37	5.39	12.35	234.30	104.74	5.45
2008	7.97	2.50	373.02	6.03	12.28	246.18	112.02	5.83
2009	8.55	3.02	386.08	6.51	12.37	234.51	91.99	6.91
2010	9.12	3.27	400.82	7.41	12.42	276.51	107.02	7.85
2011	9.32	3.43	410.64	8.49	12.46	349.06	149.44	8.33
2012	9.76	3.55	423.75	9.62	12.50	328.01	128.47	9.01
2013	10.31	3.60	435.62	10.44	12.59	410.60	150.32	9.85
2014	11.18	3.69	446.39	11.19	12.63	463.72	176.72	10.57
2015	12.10	7.47	457.73	12.35	12.70	531.72	239.44	10.87

Source: Compiled from the "China Statistical Yearbook of the Tertiary Industry 2016"

Figure 11: China's Rapidly Expanding High-Speed Railways



Source: Compiled from respective editions of the "China Statistical Yearbook" and the Chinese government's high-speed

railway development plan. Year-on-year figures are estimates. The values given for 2020 and 2025 are official government targets.

This next section offers an overview of the current state of China's transportation system based on data sourced from the China Communications and Transportation Association, since the current system will serve as the foundation for future development. At the end of 2015, the service distance of China's railway had reached 121,000 kilometers, making it the world's second longest, and its high-speed rail network exceeded 19,000 kilometers in length, making it the longest in the world. It is close to creating a network of passenger-dedicated high-speed lines supplemented by its existing intercity rail network. China's double-tracking and electrification rates have risen to 53.5 percent and 61.8 percent, respectively. Large-scale freight corridors running east-to-west and north-to-south across China are nearing completion, and the necessary logistics facilities are being developed simultaneously, thereby bringing the goal of direct, high-speed, heavy-load freight transport ever closer. China's road network has also expanded considerably, with total road length now exceeding 4.57 million kilometers, of which 123,500 kilometers are the service distance of expressways (the longest in the world), whilst its national and provincial highways now offer links to all county-, prefecture-, and provincial-level cities nationwide. Progress has also been made in the development of water transport infrastructure, and the network of main and branch line waterways is now complete. As of the end of 2015, there were some 31,300 quay berths in Chinese ports, including 2,221 berths of 10,000-ton class or above and 1,173 quay berths dedicated to processing coal, crude oil, metallic ores and container cargoes, thereby raising Chinese standards in the handling of jumbo loads, deep-water berthing, specialization and automation in port operations. China has some 127,000 kilometers of navigable inland waterways, 52.5 percent of which are graded, with 13,600 kilometers being high-grade shipping channels. China has improved navigation conditions in the Yangtze and Xijiang rivers and the Beijing-Hangzhou Grand Canal, and is close to creating an inland waterway system comprising "Two Horizontal, One Vertical, Two Networks and Eighteen Lines"[2]. A commercial airport system is now in place, comprising 210 commercial transport airports. China now has an air transport network comprising international hub airports in Beijing, Shanghai and Guangzhou, regional hub airports in provincial capitals and major cities, and a number of other airports, which supplement the network's trunk and branch routes. The network of oil and natural gas pipelines is close to completion and, as of the end of 2015, China's onshore oil and gas pipelines had a total length of 112,000 kilometers, covering 31 administrative districts nationwide and forming a three-pronged network of pipelines for crude oil, petroleum products and natural gas, which transports oil from west to east and north to south, natural gas from west to east and north to south, and brings gas from offshore. As of 2015, China's passenger transport volume had reached 3,005.89 billion passenger-kilometers, representing a 2.45-fold increase on 2000, whilst its freight turnover had reached 17,835.59 billion ton-kilometers, or a 4.02-fold increase on 2000, with the increase in freight turnover outstripping that in passenger turnover.

[2] Referred to as the "Two Horizontal, One Vertical, Two Networks and Eighteen Lines " layout, this corresponds to the concept behind the plans for the layout of national ports that was set forth in the 2007 "National Plan for Inland Waterways and Ports". Specifically, it comprises the two main arteries of the Yangtze and Xijiang rivers (two horizontal), the Beijing-Hanzhou Grand Canal (one vertical), the network of high-grade shipping channels in the Yangtze and Pearl River deltas (two networks), and 18 main waterways (eighteen lines).

China's progress in developing its transport infrastructure has yielded significant improvements in the convenience and efficiency of both passenger and freight transport, but its transport system still lags far behind those of the world's major industrial powers. According to China Communications and Transportation Association data, the average density of China's rail and road networks in 2016 had reached 129 kilometers per 10,000 square kilometers and 48.85 kilometers per 10,000 square kilometers, respectively, which represents 70 percent and 66 percent of America's respective network densities, a mere 24 percent and 15 percent of the respective densities in Japan, and 58 percent and 28 percent of the respective network densities in India, a developing country with a similar sized population to China's. Again, the ratios of deep-water berths in Chinese ports and its airport density remain low (China has just 0.23 airports per square kilometer, as compared to 2.5 airports per square kilometer in the developed world), whilst its pipeline density is a mere 15 percent of America's, suggesting that China faces numerous challenges in the development of a truly comprehensive transport system[3]. Added to which, changes in the structural ratios of passenger and freight turnover by mode of transport (**Table 10**) argue that the impact of enhanced and/or expanded transport infrastructure development on passenger and freight throughput will vary depending on how integrated and correlated the development of the transportation system as a whole is. The issues of complementarity and competition between modes of transport have been addressed down the line, and are expected to pose serious challenges for China. The rapid evolution of China's high-speed railway has brought problems with making efficient use of conventional routes to the surface, whilst the monopoly of railway operations, which are regulated, by state-owned enterprises is damaging, and these issues could become more serious down the line as they did for Japan heretofore.

Table 10: Changes in the Structural Ratio of Passenger and Freight Turnover by Mode of Transport

FY	Structural ratios by mode of passenger transport				Structural ratios by mode of freight transport				
	Rail	Road	Water	Air	Rail	Road	Water	Air	Pipeline
2000	37.0	54.3	0.8	7.9	31.1	13.8	53.6	0.11	1.4
2001	36.2	54.8	0.7	8.3	30.8	13.3	54.5	0.09	1.4
2002	35.2	55.3	0.6	9.0	30.9	13.4	54.3	0.10	1.3
2003	34.7	55.7	0.5	9.1	32.0	13.2	53.3	0.11	1.4
2004	35.0	53.6	0.4	10.9	27.8	11.3	59.7	0.10	1.2
2005	34.7	53.2	0.4	11.7	25.8	10.8	61.9	0.10	1.4
2006	34.5	52.8	0.4	12.3	24.7	11.0	62.5	0.11	1.7
2007	33.4	53.3	0.4	12.9	23.5	11.2	63.4	0.11	1.8
2008	33.5	53.8	0.3	12.4	22.8	29.8	45.6	0.11	1.8
2009	31.7	54.4	0.3	13.6	20.7	30.4	47.1	0.10	1.7
2010	31.4	53.8	0.3	14.5	19.5	30.6	48.2	0.13	1.5
2011	31.0	54.1	0.2	14.6	18.5	32.2	47.3	0.11	1.8
2012	29.4	55.3	0.2	15.1	16.8	34.3	47.0	0.09	1.8

[3] Remark by Derong Wang, Executive Vice President of the China Communications and Transportation Association "Promoting Structural Reform on the Supply Side and Building a Modern Comprehensive Transportation System in China)" March, 22, 2017.

2013	38.4	40.8	0.2	20.5	17.4	33.2	47.3	0.10	2.1
2014	38.6	40.1	0.2	21.0	14.8	32.8	49.9	0.10	2.3
2015	39.8	35.7	0.2	24.2	13.3	32.5	51.5	0.12	2.6

Source: As for Table 9. The figures for passenger and freight turnover are based on 100 million passenger-kilometers and 100 million ton-kilometers, respectively.

In the near term, heavy investment in the various projects is expected to produce significant economic outcomes, but China has yet to iron out its problems in the area of revenue sources. According to the Development Plan and to statements given by government officials, various forms of financing, including private capital (public-private partnerships, included), are indicated, but given media reports of expanded investment in transport infrastructure across China's regions it seems likely that funding in the form of bank loans and bond issues by regional governments and state-owned transport development companies will be the primary source of finance, which argues that China has yet to secure the vast sums needed to accomplish its transport system goals. Recent research points to the expansion and extension of debt incurred by investors in China's high-speed railway construction[4], exposing future limitations on railway construction financing and the challenges China will face in this area down the line, and the reality is that China is proactively seeking ways to switch over to a system of financing that utilizes private capital, though the process is one of trial and error. Moreover, the "co-ordination of transport", a policy ideal that gained currency in Europe and North America in the late 1920s and in Japan in the mid-1990s[5], and China will need to deal with a number of latent issues in the years ahead, including overcoming the difficulties involved in building the infrastructure and networks required for an efficient transport system (an experience shared by the developed countries of the world), finding ways to address competition and harmonize the development of high-speed railways, expressways and commuter flights, finding ways to conserve national land resources by the construction of transport infrastructure and a three-dimensional transport network, and ensuring that the various transport agencies and transport facilities are managed efficiently.

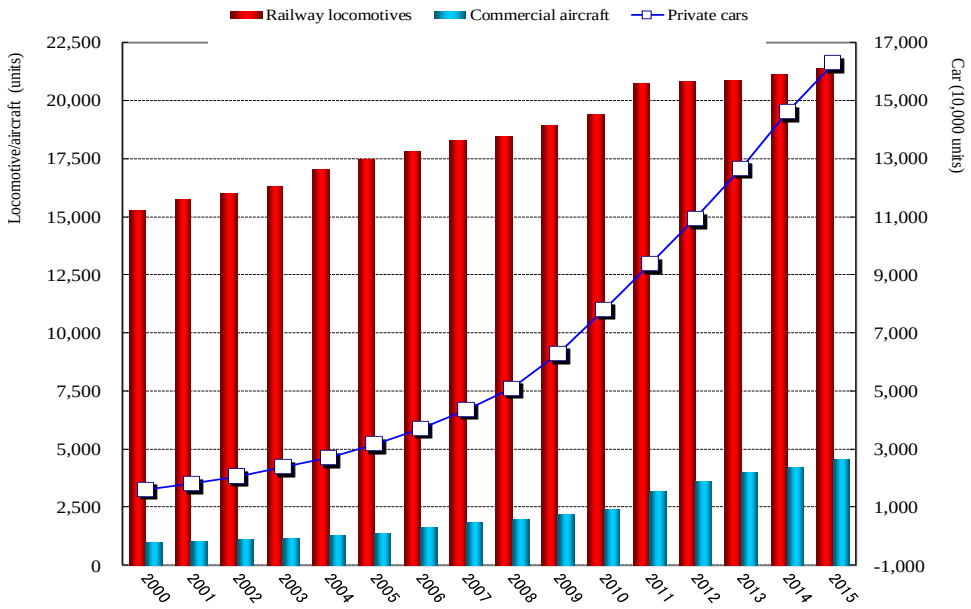
Many of the challenges China faces are either latent or problems for the future, but given how much it has already accomplished development-wise, the content of the latest Development Plan, the deployment of the government's development promotion system and the necessity of ensuring economic growth, it seems highly likely that China will accomplish the goals it has set for its transport system. As to the prospects for the development of a modern, integrated transport system in China, the opportunities and the possibilities for business would seem to outweigh any issues within the industry and/or with private-sector companies. Added to which, the Development Plan is not only expected to promote the growth of the service industry, which has been making a larger contribution to the growth of China's economy in recent years, but also for upgrading the machine industry, in which structural adjustment has been proceeding apace, it is expected

[4] Cheng Hua, Hiromasa Goto, 'Chapter 5: Financing China's High-Speed Railways' of "Diversity in Transport Infrastructure" (Hyoronsha, 2017), edited by Koichiro Tezuka and Kazusei Kato. Fumio Kurozaki, 'The Current State of Management in China's Railways: The Recent Boom in High-Speed Rail Construction and the Issues China Faces', "Transportation and the Economy", Volume 75, Issue 2, 2015.

[5] According to "Course on Public Regulation and Industry, (4) Transportation" (NTT, 1995) edited by Yoshitsugu Kanemoto and Hirotaka Yamauchi, "co-ordination" refers to the process of finding the appropriate blend of transport providers across the various different forms of transportation to deliver maximum service at minimum cost, which is a superlative policy ideal, but one that has proven extremely difficult and complex for governments to implement, a problem that China is now encountering.

to have beneficial policy outcomes by leading to increased demand of modern transport equipment (**Figure 12**) which is more technically advanced. It seems likely that by 2020, the end year of the Development Plan, China will have created the business environment to dramatic improvements in China's transport system, significant improvements in accessibility to labor, human resources and funding, progress in the area of regional partnerships, market integration and traffic with the global community, a smaller urban-rural gap and cheaper population migration and logistics costs.

Figure 12: Recent Growth in Number of Major Transport Facilities in China (2000 - 2015)



Source: "China Transportation Yearbook 2016"

Fund-raising via investment companies

The administrative impact of foreign exchange control deregulation

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1. Introduction

In 2004, China amended and promulgated provisions governing the establishment of investment companies by foreign investors[6]. Since then, it has steadily updated the legal regulations pertaining to investment companies. In 2012, the Ministry of Commerce promulgated rules governing equity contributions involving foreign-funded enterprises. These clarified the procedures for establishing a subsidiary via an investment company[7]. In 2015, meanwhile, the authorities scrapped the requirement that an "investment company's registered capital shall be no less than 30 million USD[8]."

At the same time, the rules have also been gradually relaxed when it comes to foreign investment, so it could be said the direct merits of establishing an investment company are growing less pronounced than before. One thing initially cited as a function unique to investment companies is the ability to make capital investments via foreign debt/capital funds. This is still commonly cited as a merit of investment companies.

However, the rules governing foreign currency controls have been relaxed in stages from the end of 2012, so there have also been many procedural changes regarding foreign debt/capital funds. This report examines some procedural points to consider when a subsidiary of an investment company raises funds utilizing the investment company's foreign debt/capital funds.

2. Fund-raising methods for investment company subsidiaries

Many Japanese companies have established investment companies to control their Chinese operations, for example. Other Japanese firms have consolidated their equity interests in Chinese subsidiaries under the umbrella of an investment company (thus turning these subsidiaries into subsidiaries of the investment company).

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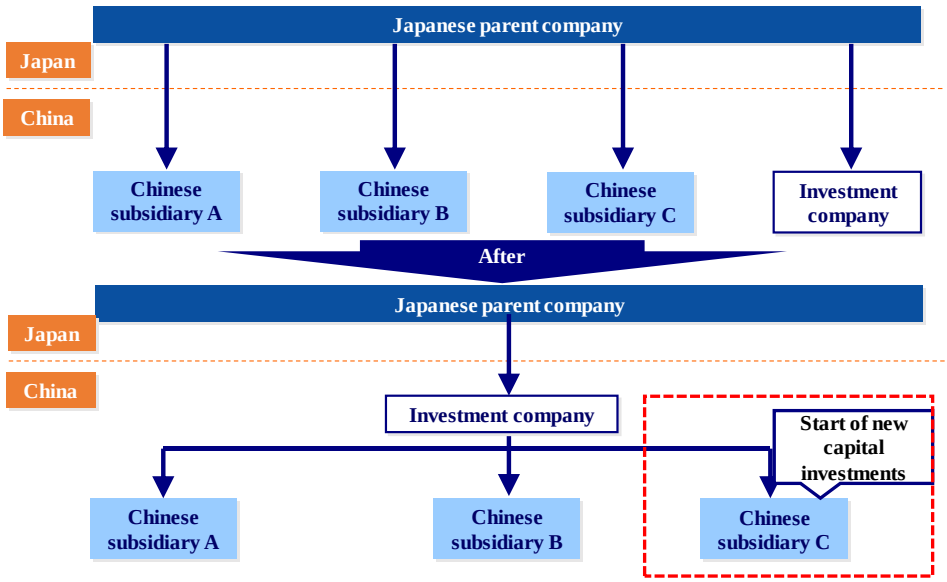
[6] The *Provisions on the Establishment of Investment Companies by Foreign Investors* (Order of the Ministry of Commerce No.22 [2004], hereinafter referred to as "Order No.22")

[7] The *Interim Provisions of the Ministry of Commerce on Equity Contribution in Foreign-funded Enterprises* (Order of the Ministry of Commerce No.8 [2012])

[8] Abolished in accordance with *The Decision on Revising Certain Regulations and Regulated Documents* (Order of the Ministry of Commerce [2015] No.2, hereinafter referred to as "Order No.2"). However, opinions differ between regions when it comes to the abolishment of the criteria that "registered capital shall be no less than 30 million USD."

Fig. 1: Example of scheme for establishing a subsidiary via an investment company



Source: Compiled by the China Business Promotion Department of Mizuho Bank

Furthermore, there are cases whereby an investment company subsidiary (Chinese subsidiary C in Fig. 1) needs to raise new funds (new capital investments, etc.). Fig. 2 outlines three possible methods of responding to a new subsidiary's fund-raising needs utilizing contributions from the Japanese parent company and the investment company's foreign debt/capital funds.

Following the recent amendments to the rules governing foreign exchange administration, this report examines some procedural points to consider with regards to these three methods. It also outlines some points to consider when selecting which scheme to use.

Fig. 2: Fund-raising methods for investment company subsidiaries (examples)

Fund raising methods (examples)

- **Examination of fund-raising methods for a new capital investment by the investment company subsidiary (Chinese subsidiary C)**
- **The Japanese parent company plans to contribute funds for the new capital investment**

	Fund-raising methods for investment company subsidiaries (examples)
(a)	After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company supplies an entrusted loan to the subsidiary
(b)	After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company injects more capital into the subsidiary
(c)	After the Japanese parent company injects more capital into the investment company, the investment company injects more capital into the subsidiary
Others	・The investment company injects more capital into the subsidiary by siphoning dividends from investment sources ・The investment company supplies an entrusted loan to the subsidiary ・The Japanese parent company directly injects capital into the subsidiary or extends a parent-subsidiary (inter-company) loan ・Entrusted loans between subsidiaries, pooling, etc.

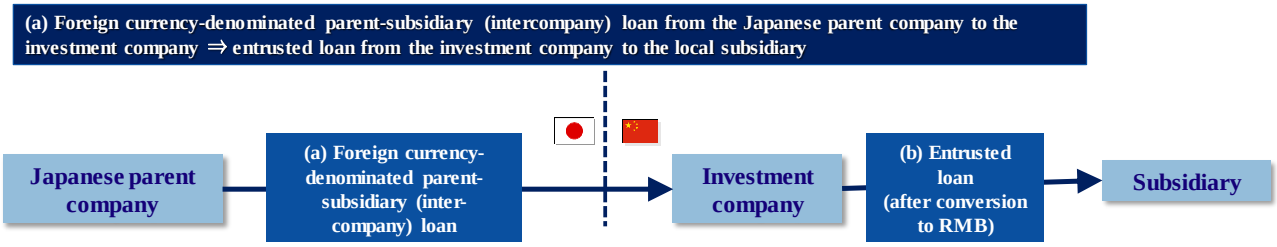
Source: Compiled by the China Business Promotion Department of Mizuho Bank

2.1 Entrusted loans from an investment company to a subsidiary

An investment company's foreign debt quota can be a maximum of 4 or 6 times the contributed amount

of registered capital[9]. One way of using this generous foreign debt quota is method (a) in Fig. 2: "After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company supplies an entrusted loan to the subsidiary.[10]" This method became available in June 2016 after the State Administration of Foreign Exchange implemented the *Circular of the SAFE on the Policies for Reforming and Standardizing Management of Foreign Exchange Settlement under the Capital Account (Huifa No. 16 [2016]* (hereinafter referred to as "Circular No. 16")[11].

Fig. 3: A scheme for utilizing an investment company's foreign debt quota



Source: Compiled by the China Business Promotion Department of Mizuho Bank

Before the promulgation of Circular No. 16, foreign currency-denominated foreign debts could only be used for entrusted loans involving small loan companies or leasing companies. However, the rules were subsequently relaxed. Circular No. 16 states that foreign debt "shall not be used to issue loans to non-associated companies," which means foreign currency-denominated foreign debt can now be used to issue loans to associated companies after conversion into RMB.

The scheme outlined in Fig. 3 is now possible following this loosening of the rules. In this scheme, the Japanese parent company extends a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company. The investment company then establishes a 'special account for foreign debts' and an 'account for foreign exchange funds settled and to be paid.' The investment company then supplies an entrusted loan to its subsidiary, an 'associated company[12].'

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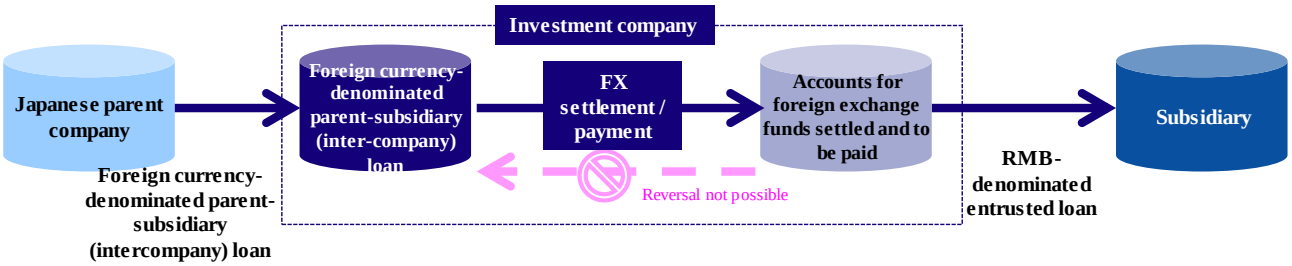
[9] Order No.22, Article 9: *If the registered capital of an investment company is no less than 30 million USD, the amount of loans shall be no more than 4 times of the contributed amount of registered capital. If the registered capital of an investment company is no less than 100 million USD, the amount of loans shall be no more than 6 times of the contributed amount of registered capital.* According to Order No.2, an investment company can be established with less than 30 million USD of registered capital. In these cases, though, it will be necessary to confirm the opinions of the relevant authorities in the company's registered locality with regards to foreign debt quotas.

[10] In addition to foreign currency-denominated foreign debt, another possible scheme involves supplying an entrusted loan after conversion into RMB for a foreign currency-denominated capital fund. However, the handling of these cases varies substantially from region to region, with prior examination sometimes required by the SAFE authorities in the company's registered locality, for instance, so this scheme is not discussed in this report.

[11] Rules governing the use of foreign currency-denominated foreign debt after conversion into RMB were relaxed on a trial basis in four free trade zones (Shanghai, Tianjin, Fujian and Guangdong) in December 2015, with the deregulation then rolled out nationwide in June 2016

[12] In theory, an investment company can also use foreign currency-denominated foreign debt for an entrusted loan without a foreign exchange settlement, but the foreign exchange administration rules on this point are unclear. Though it has no legally binding power, the Q&A found in the link provided below states that the rules pertaining to foreign currency-denominated entrusted loans in the *Provisions on the Collective Operations and Administration of Foreign Exchange Funds of Internal Members of Domestic Enterprises (Huifa No.49 [2009])* allow for the supply of foreign currency-denominated entrusted loans using foreign currency-denominated foreign debt. However, the same problem still applies as it does with foreign currency-denominated bank loans in China, namely that after receiving the foreign currency-denominated entrusted loan, the subsidiary (the loanee) can only convert the loan into RMB for transactions relating to export trade in goods.
For details, please see "全国版"外债资金意愿结汇政策释疑(第二期) (Chinese only):
http://www.chinaforex.com.cn/index.php/cms/item-view-id-40994.shtml

Fig. 4: Image of an 'account for foreign exchange funds settled and to be paid'



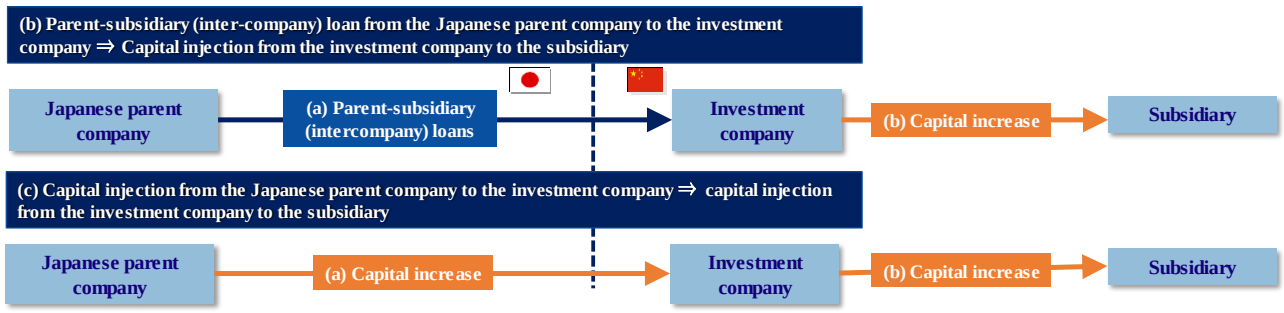
Source: Compiled by the China Business Promotion Department of Mizuho Bank

Parent-subsidiary (inter-company) loans from Japanese parent companies to investment companies can only be denominated in foreign currencies. This is because Article 16 of the *Circular on Clarifying the Operational Rules of RMB Account Settlement for Foreign Direct Investment (Yin Fa [2012] No. 165)* (hereinafter referred to as "Circular No. 165") prohibits the use of RMB-denominated foreign debt for entrusted loans (as of April 2017).

2.2 Capital injections from the investment company into the subsidiary

As outlined in Fig. 2, there are two ways for an investment company to inject more capital into a subsidiary: (b) After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company injects more capital into the subsidiary; (c) After the Japanese parent company injects more capital into the investment company, the investment company injects more capital into the subsidiary. These two methods have been available for some time, but there have been a number of procedural changes recently after the rules governing foreign exchange administration were relaxed.

Fig. 5: Schemes for an investment company to inject more capital into a subsidiary



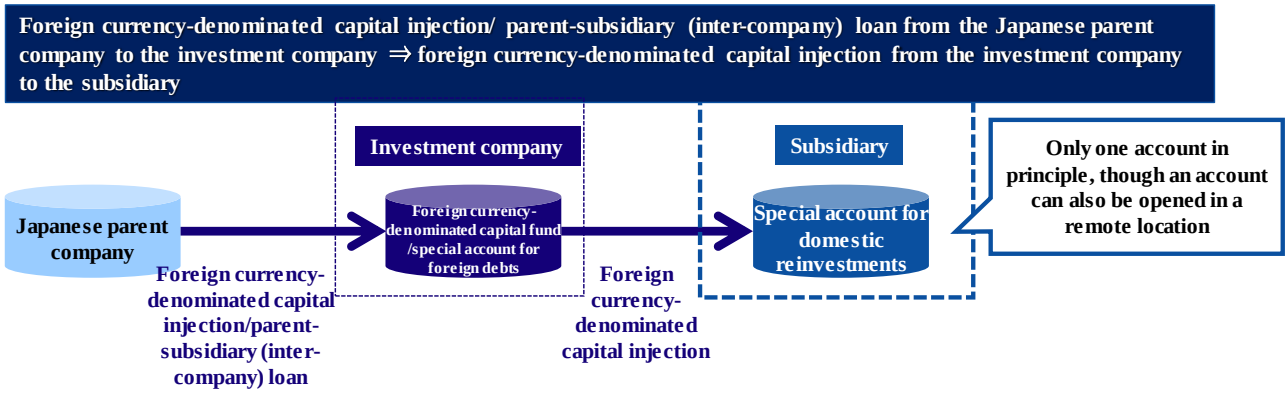
Source: Compiled by the China Business Promotion Department of Mizuho Bank

After receiving a foreign currency-denominated parent-subsidiary (inter-company) loan or capital injection from the Japanese parent company, the first administrative point for an investment company to consider is whether to convert the funds into RMB or leave them denominated in the foreign currency when injecting them into the subsidiary.

As outlined in Fig. 6, when an investment company injects foreign currency-denominated capital into a

subsidiary after receiving a foreign currency-denominated parent-subsidiary (inter-company) loan or capital injection from the Japanese parent company, the investment company first needs to establish an account for foreign currency-denominated capital funds or a special account for foreign debt, with the subsidiary then required to open a foreign currency-denominated 'special account for domestic reinvestments.' The rules state a subsidiary can only open one 'special account for domestic reinvestments[13].' However, a company also open an account in a remote location away from the company's registered locality. In principle, the rules governing foreign exchange settlements and payments, etc. are the same for both 'special accounts for domestic reinvestments' and 'accounts for foreign currency-denominated capital funds.'

Fig. 6: Foreign currency-denominated capital injections from the investment company to the subsidiary

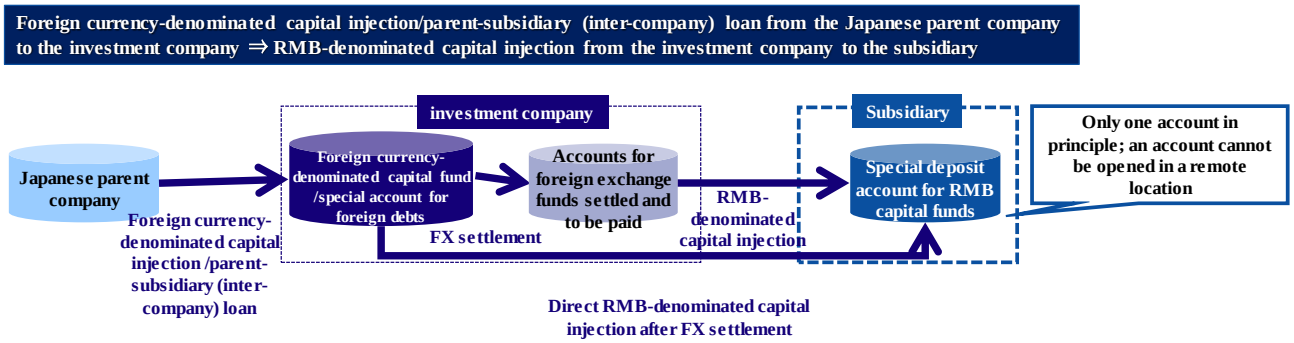


Source: Compiled by the China Business Promotion Department of Mizuho Bank

As outlined in Fig. 7, though, when an investment company injects RMB-denominated capital into a subsidiary after receiving and converting a foreign currency-denominated parent-subsidiary (inter-company) loan or capital injection from the Japanese parent company, the investment company remits the RMB-denominated funds to the subsidiary after opening an 'account for foreign exchange funds settled and to be paid' corresponding to the 'account for foreign currency-denominated capital funds' or 'special account for foreign debts' (or directly after the foreign denominated-funds in the 'account for foreign currency-denominated capital funds' or 'special account for foreign debts' are converted into RMB). The subsidiary must open a 'special deposit account for RMB capital funds' in accordance with Article 15 of the *Administrative Rules on Settlement of RMB-denominated Foreign Direct Investment PBC Document No.23 [2011]*[14].

[13] Applicable regulations: *Circular on Further Simplifying and Improving Policies for Foreign Exchange Administration for Direct Investment* (Huifa No. 13 [2015]), etc.
[14] People's Bank of China regulations require a subsidiary to open a 'special deposit account for RMB capital funds,' but some regions do not force firms to open special accounts, so the relevant authorities in the company's registered locality should be consulted with regards to the practicalities.

Fig.7: When an investment company makes an RMB-denominated capital injection into a subsidiary after converting foreign currency-denominated foreign debt/capital funds into RMB



Source: Compiled by the China Business Promotion Department of Mizuho Bank

Administrative Rules on Settlement of RMB-denominated Foreign Direct Investment

PBC Document No.23 [2011]

Article 15 Where a foreign-funded investment company, foreign-invested venture capital investment enterprise, foreign-funded equity investment enterprise or foreign-invested partnership enterprise with investment as its principal business line carries out investment business using RMB in China pursuant to the law, the invested enterprise shall, in accordance with the Administrative Rules for Administration of RMB Bank Settlement Accounts and other provisions on bank settlement accounts, apply for opening of a special deposit account for RMB capital funds exclusively for deposit of RMB registered capital or capital contribution funds and fund settlement, and the account shall not be used for cash receipt and payment.

With regards to the 'special deposit account for RMB capital funds,' be aware that the *Circular on Clarifying the Operational Rules of RMB Account Settlement for Foreign Direct Investment (Yin Fa [2012] No. 165)*(hereinafter referred to as "Circular No. 165") stipulates that only one account can be opened for each capital investment approval certificate (each notified response since October 2016) at a bank in the firm's registered locality.

Circular on Clarifying the Operational Rules of RMB Account Settlement for Foreign Direct Investment

Yin Fa [2012] No. 165

6. When establishing a foreign-funded enterprise, the foreign investor shall open a special deposit account for RMB capital funds at a bank in its registered locality upon the strength of the Approval Certificate for Foreign-funded Enterprises issued by the competent commerce authority. Only one special deposit account for RMB capital funds can be opened with each Approval Certificate and the account holder's name shall be the name of the account holder + the words 'capital fund.'

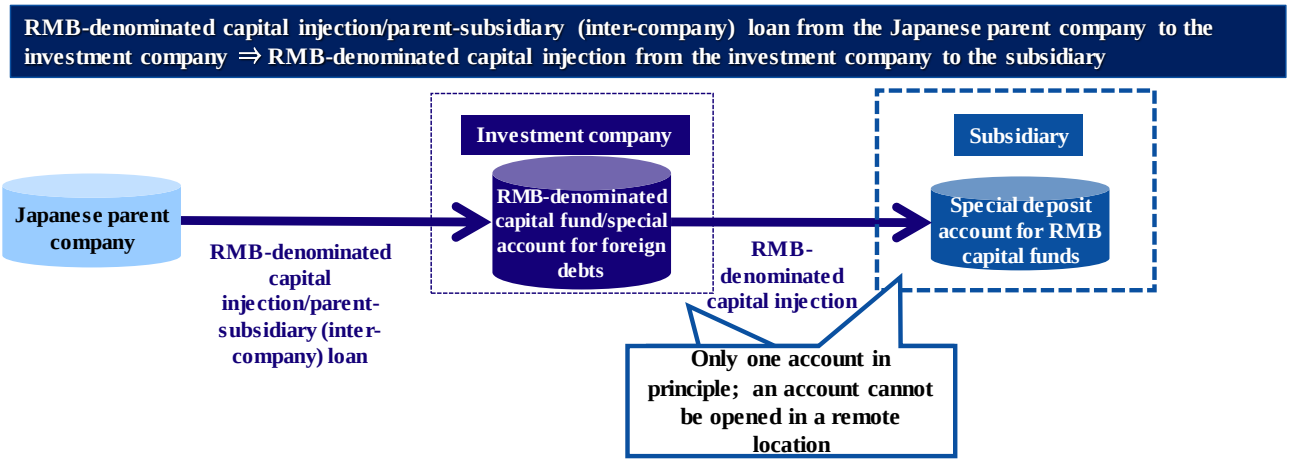
When increasing the registered capital of an existing foreign-funded enterprise, the foreign-funded enterprise shall open a special deposit account for RMB capital funds at a bank in its registered locality

upon the strength of the Approval Certificate for Changes to Registered Capital issued by the competent commerce authority. Only one special deposit account for RMB capital funds can be opened with each Approval Certificate and the account holder's name shall be the name of the account holder + the words 'capital fund.'

The aforementioned cases involve an investment company funding a capital increase with foreign currency-denominated foreign debt/capital funds. There are several schemes available depending on whether the investment company converts the foreign currency-denominated funds into RMB.

As outlined in Fig. 8, when a Japanese parent company extends RMB-denominated foreign debt/capital funds to an investment company, the settlement currency between the Japanese parent company/investment company or between the investment company/subsidiary is always RMB, so these schemes are comparatively simple.

Fig.8: When an investment company makes an RMB-denominated capital injection into a subsidiary using RMB-denominated foreign debt/capital funds



Source: Compiled by the China Business Promotion Department of Mizuho Bank

With this scheme, be aware that Circular No. 165 stipulates the investment company must also open a 'special deposit account for RMB capital funds' or a 'general deposit account for RMB overseas loans.' With regards to how the investment company manages its RMB-denominated foreign debt, prior consultation with the relevant authorities in the investment company's registered locality is required to determine whether the 'accrual management' model will continue in accordance with Circular No. 165 regulations[15].

Circular on Clarifying the Operational Rules of RMB Account Settlement for Foreign Direct Investment

[15] Since May 2016, when a foreign-funded enterprise borrows foreign debt, it must select either the traditional model of foreign debt management (a quota of up 4 or 6 times the contributed amount of registered capital for investment companies) or a macro-prudential management model. The macro-prudential model manages the total debt balance, regardless of currency type or term. With the traditional model of foreign debt management, though, the relevant authorities in each region have differing opinions on whether RMB-denominated debt should be handled using 'accrual management' or 'balance management' (as of April 2017), so caution is required.

Yin Fa [2012] No. 165

12. (omitted) *The total scale of the RMB overseas loans of a foreign-funded enterprise shall be calculated on the basis of the amount accrued. When a foreign-funded enterprise extends the term of an RMB overseas loan, the first extension shall not be factored into the total scale of overseas loans, but any further extensions will be included therein.* (omitted)

3. Points to consider for fund-raising schemes

The previous section introduced three methods of raising funds for a subsidiary using an investment company. It also examined administrative points to consider regarding opening accounts or settling foreign exchange transactions, for instance. Based on these, this section will look at some points to consider when choosing a scheme.

Perhaps the most important thing here will be selecting a fund-raising method that meets the funding needs of the subsidiary. For example, if a firm needed to make a foreign currency-denominated payment for imports of large equipment, it would probably choose to obtain foreign currency-denominated funds while procuring working capital in RMB.

In addition to the fund-raising needs of the subsidiary, though, the schemes examined in this report also require consideration of the level of recoupment difficulty of the Japanese parent company and investment company (the investor), the exchange risk as well as the procedures to be followed and the time required when procuring funds. This section will look at the three methods outlined above from the perspective of capital recovery and exchange risk.

3.1 A comparison of recoupment difficulty levels

With concerns about the Chinese economy growing, more firms are thinking seriously about how to recoup funds from local subsidiaries when examining whether to invest in China. Fig. 9 compares the three methods outlined above from the perspective of how to recoup investments.

Fig. 9: A comparison of recoupment difficulty levels

<table>
<tr><th></th><th>(a) After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company supplies an entrusted loan to the subsidiary</th><th>(b) After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company injects more capital into the subsidiary</th><th>(c) After the Japanese parent company injects more capital into the investment company, the investment company injects more capital into the subsidiary</th></tr>
<tr><td rowspan="2">Recoupment difficulty level</td><td colspan="2">・The Japanese parent company can recoup the interest and principal when the loan period comes to an end
・Withholding corporate income tax and value added tax will be applied in China to the interest on the parent-subsidiary (inter-company) loan supplied by the Japanese parent company to the investment company.</td><td rowspan="2">・Investments can only be recouped from the investment company or the subsidiary via dividends, equity transfer and distribution of residual assets after liquidation</td></tr>
<tr><td>・The investment company can recoup the interest and principal when the loan period comes to an end
・Value added tax and bank fees apply to the interest on the entrusted loan</td><td>・The investment company can only recoup its investment in the subsidiary via dividends, equity transfer and distribution of residual assets after liquidation</td></tr>
</table>

Source: Compiled by the China Business Promotion Department of Mizuho Bank

The easiest way for the Japanese parent company or the investment company to recoup investments is

though case (a), which responds to all the subsidiary's funding demands using loans. With case (a), the Japanese parent company and the investment company can both recoup interest and principle after the loan term ends. This method uses loans though, so the interest will be subject to taxation, etc.

With case (b), the Japanese parent company extends a loan to the investment company, so as with case (a), the Japanese parent company can easily recoup its investment. However, the investment company is making a capital investment, so it can only recoup this investment by getting dividends from the subsidiary transferring the equity, or liquidating the subsidiary. As such, the recoupment difficulty level is higher here than for case (a).

With case (c), the Japanese parent company and the investment company are both responding to the subsidiary's funding needs via capital increases, so recoupment methods are limited, as outlined above. Even if the investment company recoups its funds from the subsidiary via equity transfer or liquidation, the next problem is how the investment company will return these funds to the Japanese parent company.

Furthermore, when responding to funding needs via capital increases, firms will also increase their amount of legal reserves (like the 'Three Funds'), with the amount available for dividends subsequently falling.

However, a certain amount of capital investment will also be needed depending on the scale of the investment in the subsidiary, so when focusing on recoupment methods, firms will need to carefully examine each scheme after calculating the amount required to respond to the subsidiary's funding needs using capital funding.

3.2 A comparison of exchange risk

We will now compare and examine the exchange risk involved in each of the three schemes. Fig. 10 lays out which party will face exchange risk in each of the schemes: the Japanese parent company, the investment company or the subsidiary.

Fig. 10: A comparison of exchange risk

	Japanese parent company	Investment company	Subsidiary	Exchange risk
(a) After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company supplies an entrusted loan to the subsidiary	(a) Foreign currency	(a) Foreign currency-denominated parent-subsidiary (intercompany) loan converted into RMB	(a) RMB-denominated loan	**Investment company**
(b) After the Japanese parent company makes a foreign currency-denominated parent-subsidiary (inter-company) loan to the investment company, the investment company injects more capital into the subsidiary	(b) -1 Foreign currency	(b) -1-1 Foreign currency-denominated parent-subsidiary (intercompany) loan	(b) -1-1 Foreign currency-denominated capital fund converted into RMB	**Subsidiary**
		(b) -1-2 Foreign currency-denominated parent-subsidiary (intercompany) loan converted into RMB	(b) -1-2 RMB-denominated capital fund	**Investment company**
	(b) -2 RMB	(b) -2 RMB-denominated parent-subsidiary (intercompany) loan	(b) -2 RMB-denominated capital fund	**Japanese parent company**
(c) After the Japanese parent company injects more capital into the investment company, the investment company injects more capital into the subsidiary	(c) -1 Foreign currency	(c) -1-1 foreign currency-denominated capital fund	(c) -1-1 Foreign currency-denominated capital fund converted into RMB	**Subsidiary**
		(c) -1-2 foreign currency-denominated capital fund converted into RMB	(c) -1-2 RMB-denominated capital fund	**Investment company**
	(c) -2 RMB	(c) -2 RMB-denominated capital fund	(c) -2 RMB-denominated capital fund	**Japanese parent company**

Source: Compiled by the China Business Promotion Department of Mizuho Bank

If the Japanese parent company already possesses RMB or is the party facing exchange risk, it will be possible for the Japanese parent company to directly extend an RMB-denominated parent-subsidiary (inter-company) loan or directly inject more capital (Fig. 10, (b)-2 and (c)-2).

However, if the investment company in China is in charge of fund management and is in a position to tackle exchange risk, then the investment company can choose schemes that involve converting a foreign currency into RMB (Fig. 10, (a), (b)-1-2 and (c)-1-2).

This section has compared the different schemes from the perspective of recoupment methods and exchange risk when responding to fund-raising needs via an investment company, but there are other things that should be considered, such as the official procedures to follow and the time needed for parent-subsidiary (inter-company) loans and capital increases, for example, or the foreign debt quota of the investment company.

4. Conclusion

This report has examined cases where a Japanese parent company already possesses an investment company and a subsidiary. It has also looked at the administrative impact of recent foreign exchange control regulations when procuring new funds from Japan. The report also explained why deregulation means firms also need to newly consider investment recoupment methods and exchange risk. However, this report has only examined methods of fundraising by subsidiaries. Firms also need to consider how to utilize divided income from subsidiaries or how to implement pooling, etc. when examining the optimal scheme to adopt. The Ministry of Commerce is now pushing forward with deregulation and Chinese authorities are making policy more transparent by clarifying taxation procedures for establishing a subsidiary via an investment

company, for example. Firms are starting to reorganize with the aim of strengthening the control functions of investment companies. Under these circumstances, the loosening of rules governing foreign exchange administration has increased the number of ways to raise funds using investment companies. As such, from here on firms will need to respond in a timely manner to moves by the financial authorities while considering capital strategies that make full use of investment companies when doing business in China.