

Executive Summary

Introduction

In April 2010, for the first time the Japanese Chamber of Commerce and Industry in China prepared its “2010 White Paper on the Chinese Economy and Japanese Companies”. This summarized the issues faced by Japanese companies in China, aiming to develop further communication with the Chinese central and local governments. The Chamber has now released the “2011 White Paper on the Chinese Economy and Japanese Companies” as the second version.

Considering the investment environment in China for the past year, the Chinese government expressed its intention to actively use foreign investment to structurally adjust the Chinese economy by announcing “Several Opinions on Further Improving the Work of Foreign Capital Utilization”. After that, the Ministry of Commerce, National Development and Reform Commission and the State Administration for Industry & Commerce, respectively, released administrative measures to enhance efficiency including the simplification of administrative procedures regarding foreign capital investment and the transfer of authority to give permission of inspection to local governments, all of which are win-win measures for foreign companies to boost their businesses in China.

Looking at the Chinese and Japanese economies in 2010, Japan’s trade with China exceeded 300 billion dollars (statics prepared by Japan) and investment in China by Japanese companies was ranked second next to the US on a single-country base, while China increased its share of Japan’s total overseas investment to 12.6%. Japanese companies consider China as the most promising market for developing their future businesses while appreciating the high growth potential of the Chinese market.

On the other hand, in line with the rapid development of the economy and market liberalization, the issues faced by Japanese companies in China are tending to become more varied and complex.

This year again, the Japanese Chamber of Commerce and Industry in China would like to continue making efforts and discuss with the Chinese central and local governments on further improvement of the investment climate in China through this White Paper. The white paper consists of three major parts: “Common issues and proposals,” “Current status of each industry and proposals,” and “Current status of each region and proposals,” which are comprised of 26 chapters and 48 proposals.

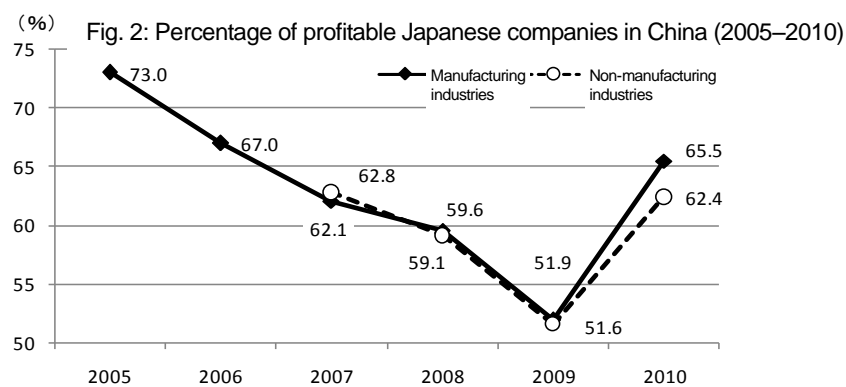
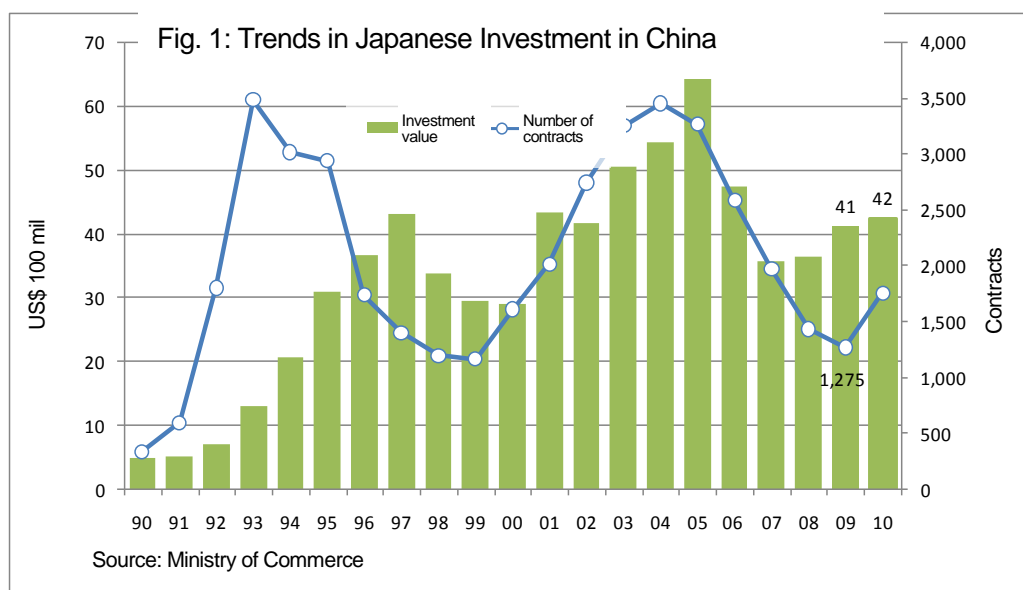
1. The Business environment for Japanese companies in China

In 2010, China’s gross domestic product (GDP) surpassed Japan, making it the world’s second largest economy. China achieved an annual growth rate of 10.3%, exceeding that of last year, and accomplished almost all its economic targets in 2010. This year is the first year of the 12th Five-Year Plan. The new Five-Year Plan positions a “faster transformation of the economic development model” as a key challenge and emphasizes “well-balanced growth between consumption, investment and exports while promoting domestic-demand expansion strategies”. Moreover, the government indicates policies to improve people’s lives through income distribution, including raising national income to a level the same as GDP growth and putting in place social security systems.

Basically, the 12th Five-Year Plan aims to go one step further than the 11th Five-Year Plan. As such, the key turning point of Chinese business was the start of the 11th Five-Year Plan, which commenced five years ago. Actually, with regard to foreign investment in China such as that made by Japanese companies, the number of projects aiming to utilize the domestic market in China has increased these past five years, in particular tie-ups with Chinese companies through M&A s and investment backed by the rapid expansion of demand for energy saving and environmental protection areas.

In 2010, investment in China by Japanese companies slightly increased 2.4% Y-on-Y, showing continuous growth since 2008 (Figure 1). Although the profitability of Japanese companies in China¹ has been on the decline in the past several years, in particular showing a drastic fall in 2009 due to the impact of the financial crisis, it recovered to the level before the crisis in 2010 (Figure 2). China is regarded as the most promising market by Japanese companies.

¹ “Survey on Japanese companies’ activities in Asia and Oceania (FY2010)” from JETRO (Number of companies surveyed: 1,359, response rate: 59.3%)



Note: Non-manufacturing industries have been covered since 2007.

Source: "Survey on Japanese companies' activities in Asia and Oceania" (annual issue) from JETRO

On the other hand, as domestic companies are also coming to the forefront, China has become a highly competitive market. In addition, various expenses including labor costs and taxes have been rapidly increasing in recent years, and they are dramatically changing the business climate in China.

Since the enforcement of the Labor Contract Act and Administrative Instructions in 2008, workers have had a heightened awareness of protecting their rights and in addition, an increasing number of domestic new-generation migrant workers have become more aware of their rights. Conversely, low income earners continue to have hard lives despite the rapid economic growth and it is said that they are increasingly becoming disaffected about not enjoying the fruits of development. This is why the Chinese government is emphasizing improving people's lives in the 12th Five-Year Plan. Due to the successive hikes in the minimum wage by local governments last year, labor costs in Japanese companies have rapidly increased. This has become a significant concern for Japanese companies in China (Chart 1).

Chart 1: Managerial problems of Japanese companies in China

		Percentage of reply
1	Rise in employee wages	79.6
2	Intense competition (in cost)	57.5
3	Increase in procurement cost	55.9
4	Quality of workers	48.4
5	Cost reduction requests by major customers	44.1
6	Sluggish development of local human resources	44.0
7	Difficulties with quality management	43.3
8	Difficulties in local procurement of materials and parts	43.1
9	Labor shortage (general workers) (manufacturing industries only)	42.7
9	Approaching cost cutting limits	42.7

Source: "Survey on Japanese companies' activities in Asia and Oceania (FY2010)" from JETRO

2. Major proposals

Although improvement points requested by Japanese companies in China vary according to the industry, there are many commonalities. The following show the major issues and improvement requests regarding common problems in nine areas including international trade and customs clearance, tax practices and accounting systems and labor.

(1) International trade and customs clearance-related issues

- The interpretation of laws or the HS code varies depending on the customs authority, and that causes many problems. Insufficient handling of customs often resulted in confusing procedures for clearing customs. If any rules or regulations related to customs clearance are to be changed, a sufficient preparatory period should be designated.
- In 2010, in line with the restriction on rare earth exports to Japan, customs clearance procedures were suddenly changed significantly. Such changes included implementing unpacking inspections for all export goods at customs clearance mainly in exports to Japan. Although the unpacking inspection for all export goods itself is fair according to the customs regulations, considering the fact that entities currently build their supply chain systems regarding manufacturing based on minimum inventories, sudden changes in customs clearance procedures may have a significant effect on the manufacturing activities of companies. We request custom clearance operations based on a clear inspection standard.
- Sometimes, it takes a very long time to obtain an HS code when importing goods and in addition, import and export control for bonded materials at customs clearance (registration hand book management) is cumbersome and inflexible. We request the simplification of customs clearance procedures.
- With regard to import usance (import deferred payment), when the usance period exceeds 90 days from the execution date of an import contract or the customs date, an importer is required to make a deferred payment registration regardless of the import amount and moreover, the annual accumulated amount of import deferred payment in the reference year must be limited to 25% of the total import payment amount in the previous year in principle. Such new regulations introduced to reinforce foreign exchange control lead to many problems such as cumbersome procedures. We request the simplification of customs clearance procedures and responses considering international practices.

(2) Tax practices and accounting system-related issues

- Currently, many final decisions on interpretation and application of tax laws and tax instructions in China are performed by the tax authorities. However, tax applications vary by regions and in some cases, individual officers in the same office may make different responses. From the viewpoint of a tax payer, the tax authorities as a whole should have the same view for individual tax matters.
- In 2009, the new provisional ordinance for the value added tax (VAT), business tax and excise tax (distribution taxes) came into effect. As non-refundable purchase VAT remains in the new VAT law, an exporter has to bear costs resulting in non-refundable rates the same as before. Such non-refundable rates are often changed suddenly and that may cause the affected tax payers various disruptions in their operations concerning budgetary and financial management. We request the government to improve such practices.
- With regard to the permanent establishment (PE) tax, the current corporate income tax law established the levying tax on non-residents in China more explicitly; however recently tax issues involved with the approval of the PE tax have frequently occurred in various regions. In terms of approving the PE tax, applying interpretations that differ from those of the past has caused many cases to be suddenly viewed with suspicion. We ask the tax authorities to promptly release explicit guidelines and apply standardized measures to ensure smooth remittances to resident officers in China.
- Currently, China has two accounting standard systems: the conventional Chinese Accounting Standards and the new Chinese Accounting Standards, which is said to be similar to International Financial Reporting Standards (IFRS). According to the law, only listed Chinese companies, enterprises in specific industries and large state-owned enterprises are subject to the new Chinese Accounting Standards. In addition, the standards began to be adopted either in 2010 or 2011 depending on the region, not all together at the same time nationwide. The new standards should be adopted in a unified way nationwide.

(3) Labor-related issues

- With regard to a labor contract with an indefinite period in accordance with the Labor Contract Act, when an employee renews a fixed-term labor contract twice, the employee should be automatically considered to have made a labor contract with an indefinite period. Such provisions make it difficult for a company to implement flexible labor management in response to business conditions such as expansion or reduction. We request corrective actions.
- The minimum wage is rising too much compared with rising prices and thus, rising wages should be held down so as to ensure they increase only gradually. Additionally, if there are guidelines concerning hiking minimum wages, we request their early announcement. We also request the government to establish nationally-standardized labor regulations in accordance with laws and regulations prescribed by the central government with the exception of minimum wages which should vary by region.
- It is said that the salary ordinance (wage ordinance) being deliberated by the Chinese government may include provisions of the “same wage for the same work” and “collective wage negotiation”. However, workers’ salary should be determined by each company (the management) based on a comprehensive assessment of various factors including the performance of each employee, contribution to the company and work behavior considering the company’s operating conditions and business results. Implementation of policies which may impair a company’s discretionary power should be reconsidered.
- We believe that social insurance, which is movable across the state, is a good measure; however the payment amount and the movable amount still vary by region and in some cases, social insurance cannot be paid at all. We request the implementation of unified measures.

(4) Intellectual property protection: status and issues

- We request heavy administrative penalties to imitation brokers, greater fines regarding administrative penalties and greater confiscation of manufacturing facilities. In addition, we request the government to consider the prices of original products when confiscated goods are evaluated and also to inform the right holder about the result of any administrative penalty.

- As a hard-hitting measure for repeat offenders of imitation products, we request the government to impose a severe punishment and to share more information on repeat offenders between administrative agencies in charge of detection.
- With regard to the “Administrative Rules of Establishment and Revision of Patent-Related National Standards (Temporary Enforcement)”, the Standardization Administration of China (SAC) should listen to the opinions of Japanese industries. In establishing and revising national standards, we request the SAC to give full attention to the rights of patent holders in addition to the simplification of procedures and the clarification of criteria for patent acquisition. Moreover, for examining the “Procedures and Regulations on Patent-Related National Standards”, an enforcement provision of the “Administrative Rules”, we also request the SAC to reflect the opinions of Japanese industries sufficiently.
- The risk of leaking technology and know-how from a business partner may inhibit Japanese companies from promoting R&D activities or transferring technologies to China. We request the implementation of a law scheme for ensuring the protection of technology, know-how and confidential business information.

(5) Energy saving and environment industry and market: status and issues

- Although the Chinese government released energy-saving and environmental policies and laws, the arrangement of relevant administrative instructions and the clarification of interpretation are still quite preliminary. Which section in the government should be responsible has not been settled yet and that is also a problem. Therefore, we would like the government to clearly determine the contact point regarding environmental regulations.
- The Chinese government set up energy saving and contamination emissions reduction targets in the 11th Five-Year Plan. In 2010, the last year of the five-year plan, as the restriction of electric power supply was imposed uniformly and suddenly in order to achieve the targets, companies were forced to reduce or suspend their plant operations. Further improvement is requested.
- With regard to the energy-saving and environmental labeling system, the accreditation, testing and labeling procedures take time and incur costs and thus, we request a greater streamlining of the relevant laws, regulations and standards. For example, unifying into one energy-saving label such as “environmentally friendly product” and approving mutual certification in regions could streamline procedures including the accreditation, factory inspection and product examination.
- With regard to the examination of Measures for Administration on the Control of Pollution Caused by Electronic Information Products (China RoHS) (enactment of new measures for administration, establishment of a priority control list, addition of subject products, administrative instructions of the China Compulsory Certification (CCC) and creation of a voluntary certification scheme for electronic information products recommended by the state), we request the government to recognize that the overall system is difficult to understand. In addition to ensure sufficient explanation to foreign companies, transparency of procedures and fairness, we request the government to take the opportunity to regularly listen to the opinions of Japanese companies.
- The full-scale implementation of the Management of Recycling and Disposal of Waste Electrical and Electronic Products (China WEEE) is delayed. We request the government to disclose information including the scope of subject products, subject of fund collection or subsidization and the amount, initial date of reckoning and commencing time of fund collection and salvage procedure management of local governments so as to examine it under transparent and fair conditions. In addition, we request strongly that the Chinese government should take the occasion to listen to the opinions of foreign companies including Japanese companies.

(6) Engineering standards and certificates: status and issues

- Some standards stipulate physically impossible testing conditions and target values that are almost ideal values. In the planning stage, actual technological development should be taken into account without excessively pursuing an ideal.
- A sufficient preparatory period from the publication date of standard to the effective date should be designated. In particular for the China Compulsory Certificate (CCC), we request the government to take one or two years for a preparatory period until the effective date, the same

as other international standards. Furthermore, the initial date of reckoning for a preparatory period should be the date when it is officially available for everyone, not the publication date.

- We request cost cuts for accreditation and testing as well as transparent procedures. We also would like the system and procedures to be simplified, inspections to be sped up, criteria for judging to be clarified, and judgment among in-charge officers to be standardized and standards to be eliminated or consolidated.
- Sometimes, a standard varies between the central government and the local government and even if they apply the same standard, their applications may differ in each case, which results in confusion in the field sites. We request the resolution of any discrepancy in applying standards and field sites so as to enhance coordination between the central and local governments.
- We request the elimination or consolidation of duplicate schemes between the CCC and similar inspection systems. For example, for an automobile, there are several government divisions managing and requesting similar requirements including the CCC, the official announcement system and the public safety inspection system during the operation flows of production, import, sale and registration. Such requirements may pose heavy burdens on automakers.

(7) Technology and innovation: status and issues

- Although the “Notification of 2010 Indigenous Innovative Product Accreditation System (draft)” has not been put into action yet, it contains vague approval requirements and there remain concerns about the possibility of excluding foreign companies’ products. We request the government to examine opinions from industries in foreign countries in terms of the clarification of the system, impartiality and fairness as well as transparency. In addition, certain systems of regional governments which have already been implemented on a trial basis ahead of that of the central government exclude foreign companies’ products. We request that regional systems should be consistent and unified with the state system.
- The “Measures set forth regarding the criteria for recognition as a hi-tech enterprise (High-Tech Enterprise Accreditation Management Rule)” requires entities that wish to be accredited as a high-tech enterprise to have a local company in China holding the intellectual property right of their main product, not a foreign company’s overseas headquarters. However, the provision is not practical for foreign companies which manage their intellectual property rights in a global strategy and therefore, it may impede fair competition. We recommend the improvement of the system.
- Unlike high-tech companies, which receive preferential treatment, certain R&D functions cannot receive government support as they are operated as a part of factory operations due to coordination with commercialization processes although they actually perform similar R&D operations to those of high-tech enterprises. From the viewpoint of promoting innovation, government support should be granted based on the details of R&D, not on the form of organization and therefore, we request a review of the system.
- We would like reliable public testing and authorized inspection institutes to be enhanced. Implementation of infrastructure which supports quality is not only advantageous for Japanese companies, but also essential to raise the quality level of Chinese products.

(8) Issues Regarding Domestic Logistics

- Presently, “minimum inventories” are the mainstream for supply chains of manufacturing companies. Although the sudden changes in custom clearance procedures including unpacking inspection are fair according to customs regulations, it has a significant effect on manufacturing activities that may affect the global demand-supply relationship. We request the government to take a cautious approach considering the actual situation.
- Cargo breakages frequently occurred due to the crude handling of cargo in the airports. In many cases, areas where cargo accidents occurred are a “sanctuary” for specific contractors with vested interests and thus, general distributors cannot obtain approval to access such areas. Such customs prevent people from giving instructions to improve working quality and make it difficult to enhance cargo transportation quality. The opening of such “sanctuaries” is desired.
- In September 2010, the Ministry of Transport required transportation companies (Non Vessel Operators) to submit their freight charges for the purpose of improving unregulated situations such as “free” ocean freight. Although penal regulations for violation are established, the methods used for supervising and maintaining order are vague. We request the implementation

of a scheme with absolute certainty. Moreover, as the period from the date of notification to the effective date is quite short, future improvement is desired.

- Limited regulations for controlling emissions from automobiles lack effectiveness and we request comprehensive environmental policies including the nationwide homogenization of fuel.
- It is hard to understand the approval of transportation operations in Gong Lu (highway) because requirements including the minimum number of fleet vehicles differ by region. We request the clarification of the standard and the abolition of ceiling regulations.
- When a distributor wants to handle cargo transportation operations directly with the Ministry of Railways, it cannot provide its services except for going through specific contractors. This reduces the competitiveness of distributors other than specific contractors in terms of freight charges or securing cargo spaces. Furthermore, as requirements for specific contractors are undefined, transparency and equal opportunities are desired.
- In efforts to respond to the demands of cargo owners, when a distributor wants to embark on a free trade zone, bonded logistics zone or bonded port zone, it is often required to establish an independent corporation. We request that operations by establishing a branch should be approved for investing, enhancing business efficiency and providing homogeneous services.

(9) Government procurement: status and issues

- We request that the Chinese government hasten efforts towards joining the WTO Government Procurement Agreement early and resolve unfairness to foreign companies in the relevant laws including the Government Procurement Act, in addition to the revision and establishment of laws that are consistent with global standards such as the WTO Government Procurement Agreement.
- Although it has already been eight years since the release of the Government Procurement Act, there are relatively few relevant laws and regulations. If this goes on, it will be difficult to standardize operations by the government procurement sections effectively and thus, many companies including Japanese companies are worried about how to respond to it. We request the early establishment and publication of a series of relevant laws and regulations including the Government Procurement Act Enforcement Regulation. In examining the establishment of such laws, we request the government to provide sufficient explanations to foreign companies and ensure transparency and fairness while also taking the opportunity to regularly listen to the opinions of Japanese companies.
- According to the “People’s Republic of China Government Procurement Act Enforcement Regulation (draft)”, “People’s Republic of China Government Procurement of National Products Management Rule (draft)” and “Formal List of Energy Efficient Products for Public Procurement”, the government procurement policy gives preference to national products by excluding import goods and generally import goods are not subject to such laws. Although the “People’s Republic of China Government Procurement Act” approves procurement of import goods with some conditions, actual implementation often differs from the provisions of the law. In order to enhance convenience for in-advance application when a procurement officer buys import goods, we request that all import goods be explicitly designated as imported in an official list.
- We request the improvement of commercial practices which require numerous negotiations on terms and conditions to be held again after the tender, in addition to the clarification and opening of qualifications and rules. Moreover, requirements for successful tenders should consider various factors including the performance conditions, efficiency and maintenance conditions in addition to price.

In the National People’s Congress held in March 2011, Premier Wen Jiabao pointed out that “increasing restrictions on natural resources and environmental protection, widening of the income gap and weak innovation capability” are likely problems as a result of the rapid economic growth. Japanese companies including service industries as well as manufacturing sectors have the world’s leading advanced technology and know-how. We believe that we can contribute to China in many areas in terms of enhancing innovation capability and developing modern services when China aims to foster strategic new businesses and accelerate the development further.

Japanese companies strongly wish to be an important partner for further development of the Chinese economy and we believe this white paper will contribute to in-depth discussions with China.