

Executive Summary

Introduction

In April 2010, the Japanese Chamber of Commerce and Industry in China prepared its “2010 White Paper on the Chinese Economy and Japanese Companies.” This was the Chamber’s first such report on 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 “2012 White Paper on the Chinese Economy and Japanese Companies” as the third version.

Considering the investment environment in China for the past year, on December 24, 2011, the Chinese government promulgated the “Catalogue for the Guidance of Foreign Investment Industries” (revised in 2011) which came into effect from January 30, 2012. The 2011 Catalogue listed 354 industries for which foreign investment is encouraged, 80 industries to be restricted and 39 industries to be prohibited. Compared with the 2007 Catalogue (revised), the number of industries to be encouraged increased by three, while the number of industries to be restricted fell by seven and the number to be prohibited decreased by one. At the same time, the 2011 Catalogue abolished foreign ownership caps for certain areas and reduced items requiring foreign ownership caps for 11 industries compared with the 2007 Catalogue, which resulted in further deregulation for foreign investors.

On April 30, 2012, the State Council released a report titled “Opinions on Strengthening Imports to Promote the Development of Foreign Trade Balance.” As a policy for increasing imports and promoting advanced industry, the “Opinions” clarify fiscal and tax support such as reducing tariffs and providing a wide range of finance facilities. They also clarify efforts to further simplify and streamline import trade structures, among other things, by improving the efficiency of administrative management services such as the General Administration of Customs, CIQ and the State Administration of Foreign Exchange. The Japanese Chamber of Commerce and Industry in China appreciated the “Opinions” and in addition, hopes for an improvement in administrative services not only for trade but also for other permitting processes and ensure the streamlining and improved efficiency of procedures.

On the other hand, many Japanese companies in China continue to voice complaints about differences between the legal system and actual practices as well as sudden changes in the systems. In addition, the issues they face 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 how to further improve 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,” and they are comprised of 27 chapters and 50 proposals.

1. The Business environment for Japanese companies in China

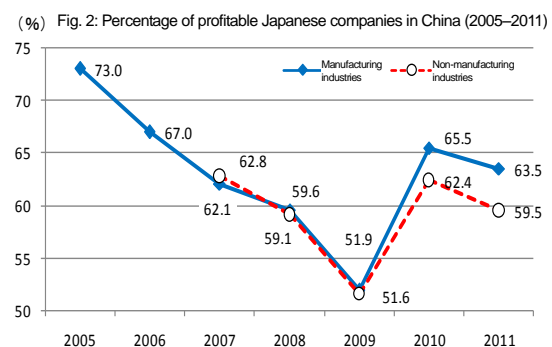
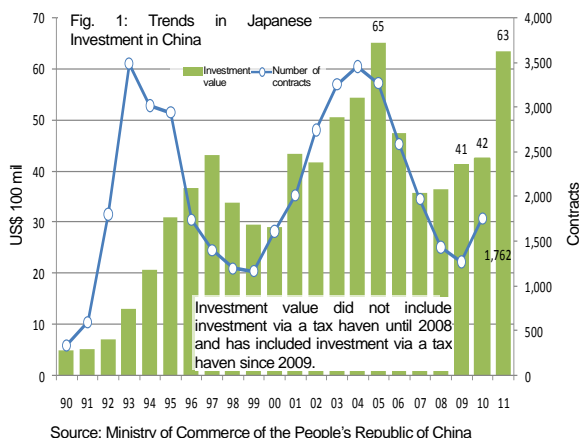
In 2011, Japanese companies’ investment in China increased significantly by 49.6% Y-on-Y (Figure 1). While total foreign investment in China slowed down to the single-digit growth of 9.7%, compared

with an increase of 17.4% in 2010, the surge in Japanese investment was prominent. Regarding investment from Japan the following is apparent: 1) there are many cases of large-scale investment by manufacturers, 2) there are many projects of transportation machinery suppliers and 3) leading companies are establishing regional headquarters in China across industries.

Some said that the growth in Japanese investment was due to the economic rebound from the Great East Japan Earthquake. But taking into account the fact that investment was most concentrated in the first half of the year, especially in March, and that direct investment was required at certain times for feasibility studies, site procurement and negotiations with counterparties, many projects were deemed to have already been examined before the Earthquake.

Investment by Japanese companies has been stagnant in recent years. But from a different viewpoint Japanese companies seem to have increased their liquidity on hand. In the midst of ongoing uncertainty about market trends in Japan, Europe and the U.S., in addition to the topping out of the yen, Japanese companies, mainly the leading players, are earnestly establishing regional headquarters or reinforcing production capacity in China. Their aim is to enhance competitiveness and expand domestic sales in China.

Looking at the amount invested by Japanese companies by industry in 2011, we can see that the strength of the manufacturing sector was outstanding. After declines in 2009 and 2010, the manufacturing sector expanded its investment significantly by 78.3% in 2011. Meanwhile, the non-manufacturing sector also showed growth of 29.7%. In particular, the wholesale and retail sectors marked the highest growth of 63.0% following on from the previous year. A drug store chain launched operations in Shanghai and other retailers that had already been operating in China, including electronics retail stores, department stores and convenience stores, have developed their store networks to reach less competitive areas. The result is they are actively launching new stores in various regions. Focusing on high growth potential in China, Japanese companies are accelerating their business development in the country and regard it as the most promising market for future business development.



Note: Non-manufacturing industries have been covered since 2007.
Source: "Survey on Japanese companies' activities in Asia and Oceania" (annual version) from JETRO

On the other hand, the profitability of Japanese companies in China declined between 2010 and 2011, when seen from the percentage of profitable companies (Fig. 2). In the Chinese market,

business expenses related to labor and taxes as well as procurement costs including those for raw materials have increased significantly. In particular, due to the successive hikes to the minimum wage in recent years, labor costs in Japanese companies have rapidly increased. In response to JETRO's questionnaire survey¹ performed during August and September 2011, more than 70% of companies said that rising personnel costs were the reason why their operating profit had fallen.

2. Major proposals

Although areas of improvement requested by Japanese companies in China vary according to the industry, there are many common points. The following is a description of major issues and improvement requests regarding common problems in ten areas including international trade and customs clearance, tax practices and accounting systems and labor. We present two types of requests: those which companies requested before in past White Papers ("ongoing proposal") and those which are newly requested in this White Paper ("new proposal").

(1) International trade and customs clearance

- Customs clearance procedures regarding import and export declarations such as the HS code of identical products and certificates of origin, and operations, regulations and the interpretation of regulations by free trade zones, bonded logistics zones or bonded port zones vary depending on the region or the customs authority. We request unified customs operations. [Ongoing proposal]
- Although the Information Technology Agreement (ITA) has greatly helped to spur growth in the global economy by abolishing tariffs on IT products, it is becoming increasingly necessary to review the current agreement from various aspects because 15 years have passed since its conclusion. Accordingly, we think that member nations of the ITA should start negotiations as soon as possible with regard to extending the scope of products subject to the ITA considering technological development, establishment of a regular review structure and an increase in the number of member countries. We strongly request that the Chinese government, as one of the leading countries in the global economy, agrees to the idea of expanding the ITA and actively participates in negotiations. [New proposal]

(2) Tax practices and accounting system

- In terms of the management of tax collection, we request tax practices which ensure a structure that helps taxpayers pay an appropriate amount of tax, eliminates differences between regions and reduces room for regional tax authority's discretion wherever possible. [Ongoing proposal]
- There is a tendency for the authorities to impose personal income taxes on employees dispatched from Japanese companies on the portion of social insurance that comes from their company in Japan. If such taxes are introduced, taxpayers will bear a large burden in terms of tax procedures and costs. Therefore, we ask you to clarify that such cost is tax exempt as in the past. [New

¹ "Survey on Japanese companies' activities in Asia and Oceania in 2011," JETRO (Number of surveyed companies: 1,445, response rate: 63.0%)

proposal]

(3) Labor-related issues

- The minimum wage is rising too much compared with rising prices and thus, rising wages should be held down so as to ensure that they increase only gradually. Additionally, if there are guidelines concerning rises to minimum wages, we request their early announcement. We also request the government to establish nationally standardized labour regulations in accordance with laws and regulations prescribed by the central government with the exception of minimum wages which should vary by region. [Ongoing proposal]
- We request that foreign expatriates may elect to participate in social insurance programs voluntarily. While a law with a mandatory requirement for foreign workers to join a social security system has been enforced, we request the governments in Japan and China to enter into a treaty for preventing issues such as duplicate payment of insurance premium or no refund payment. [New proposal]

(4) Intellectual property rights protection

- In order to deter repeat intellectual property rights offenses, it is necessary to identify when such acts are repeated. Accordingly, it is necessary to standardize the criminal acts that are classed as “repeat offenses” and share punishment information among central and regional bodies including the State Administration for Industry and Commerce, Bureau of Quality and Technical Supervision, General Administration of Customs and Public Safety Commission. To increase the deterrent effects, we request greater facilitation of cases transferred to the Public Safety Commission from administrative agencies. [Ongoing proposal]
- Prompt and adequate patent examination: The examination period of patent applications in China has been reduced drastically in recent years. But to ensure adequate protection of patent rights, it is necessary to shorten the examination period further while maintaining the quality of examinations. Thus, we request the prompt official entrance by the Chinese government in the patent prosecution highway with Japan (the Japan-China PPH) and expansion of areas subject to early examination, even if they are not stipulated under the Japan-China PPH. [New Proposal]

(5) Energy saving and environment industry and market

- With regard to the energy-saving and environmental labeling systems, the accreditation, testing and labeling procedures take time and incur costs. Thus, we request a greater streamlining of the relevant laws, regulations and standards. For example, unifying energy-saving labels such as “environmentally friendly product” and approving mutual certification in regions could streamline procedures including accreditation, factory inspections and product examinations. [Ongoing proposal]
- Although the Management of Recycling and Disposal of Waste Electrical and Electronic Products (China WEEE) took effect in January 2011, the promulgation and enforcement of measures

concerning the management of recycling funds was delayed. We request the government to operate the recycling fund management system based on a fair collection of funds from manufacturers and managers. We also ask that funds be managed in a transparent and rational manner. Further, we ask the government to examine this system by ensuring consistency and collaboration with relevant systems including China's Restrictions of Hazardous Substances Directive and to execute the system in a comprehensive and efficient manner. [Ongoing proposal]

(6) Technical standards and certification

- 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 in calm discussions with companies and consumers. [Ongoing proposal]
- With regard to accreditation, we request that provisions or internal notes which may have an impact on companies should be officially released on the website immediately, not only informed to parties via meetings. [New proposal]

(7) Technology and innovation

- The "ratio of R&D expenses to sales" is one of the approval criteria for high-tech companies in China. Even if R&D activities are not changed, increasing sales may cause a lack of consistency with the criteria. Thus, in calculating the ratio, we would like to exclude sales related to import sales of finished goods from total sales. [Ongoing proposal]
- We were very pleased that linkage with government procurement was abolished in the "Indigenous Innovative Product Accreditation System" and we also request that arbitrary rules are prevented in actual operations. In addition, some regional government systems exclude foreign companies' products. We request that regional systems should be consistent and unified with the state system. [New proposal]

(8) Domestic Logistics

- When Customs achieve their target annual tax revenue during the year, they often wish to carry forward revenue of customs duties or value added tax so as to record it in the following year. Hence, sometimes they may not approve goods to pass through customs officially but let them pass by having a guarantee deposited. Then in the following year, they will levy customs duties or value added tax on those goods. Such practices may force distributors or cargo owners to take cumbersome procedures and bear the burden of cash management. Conversely, when annual tax revenue falls short of the goal, Customs may make unreasonable requests to distributors or cargo owners. We ask Customs to not operate in ways that are convenient just for them. [Ongoing proposal]
- In 2012, Shanghai levied value added tax on distributors on a trial basis but it took less than two months from the announcement to the enforcement and in addition, there are no by-laws assuming various individual cases. In China, value added tax is not generally expressed as a tax-excluded price and seems to be considered as a "cost" in each transaction stage. Value added tax imposed on purchase costs and profits in distributing operations cannot be actually

passed on to transaction prices for the most part. We request the government to sufficiently prepare for the introduction of value added taxes instead of taking a speed-before-quality approach, by taking such measures as telling people that a value added tax is not a “cost” and developing by-laws assuming various cases. [New proposal]

(9) Government procurement

- Integration of government procurement-related regulations to global standards: China urgently needs to develop and operate transparent trade and investment structures without any differences from those overseas. This befits the current presence of China in the global economy. Accordingly, we request the government to accelerate procedures to join the WTO Agreement on Government Procurement immediately and eliminate any discrimination of foreign companies in the Government Procurement Act and other applicable laws in accordance with global standards such as the WTO Agreement on Government Procurement. [Ongoing proposal]
- The “Enforcement Regulations of the Tendering and Bidding Law” was promulgated on December 20, 2011 and became effective in February 2012. In accordance with provisions of the “Tendering and Bidding Law,” the “Enforcement Regulations of the Tendering and Bidding Law” approved functions of “instruction” and “arrangement” by the National Development and Reform Commission of the State Council in the tendering and bidding stages. However, the Government Procurement Act granted “supervising and managing” functions in government procurement activities to the Ministry of Finance. Tender activities play a significant role in government procurement. Thus, without clarifying the segregation of duties between these government agencies, entities participating in tender activities are at high risk of being adversely affected. Accordingly, we ask for the relationship between the Government Procurement Act, the Tendering and Bidding Law and these enforcement regulations to be clarified and for them to be unified. [New proposal]

(10) Organization of Chamber of Commerce and Industry in China

- We request a revision of regulations on the Foreign Chamber of Commerce and Industry in order to approve branch organizations and grant corporate status to regional chambers of commerce and industry as well as Japanese societies so as to ensure flexible activities.

Japanese companies, not only in manufacturing sectors but also service sectors, have globally pre-eminent and advanced technologies and expertise. We think we can contribute to many areas that China is aiming to further develop including enhancing innovative capability, developing modern service industries and expanding consumption. Japanese companies strongly wish to be an important partner for the further development of the Chinese economy and we believe this white paper will contribute to in-depth discussions with China.