

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 “2013 White Paper on the Chinese Economy and Japanese Companies” as the fourth version.

In the National People's Congress in March 2013, the Chinese government has adopted the institutional reform plan of the State Council and its functional transformation. For the purpose of building more service-oriented government functions, as the functional transformation, the government plans to reduce or simplify the review and approval of investment projects; reduce the number of review and approval items regarding business and operation activities; reduce administrative fees and charges and abolish unreasonable charges; and gradually loosen conditions regarding the registration of industrial and commercial entities. This reform package is expected to improve government services and simplify and promote the efficiency of administrative procedures, and it may serve as a tail wind for foreign companies in China.

On the other hand, many Japanese companies in China continue to voice their 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 28 chapters and 52 proposals.

1. Business environment for Japanese companies in China

In 2012, Japanese companies' investment in China increased 16.3% year-on-year to USD7,380 million and hit a record high by exceeding the USD6,529.77 million recorded in 2005 (Figure 1). Total investment in China in 2012 posted year-on-year losses (for the first time since 2009), down 3.7%; investment from the UK showed a sharp drop of 36.0% year-on-year while that from the US slightly increased by 4.5% year-on-year. Considering these facts, Japan's aggressive investment was noticeable.

Looking at Japanese investment in China by industry sector, investment in 2012 was mainly done by the manufacturing sector, the same as the previous year. This substantially differs in the fact that more than half of global investment in China was carried out by non-manufacturers, and among others the real estate sector has a 20% share of the total investment (“China Monthly

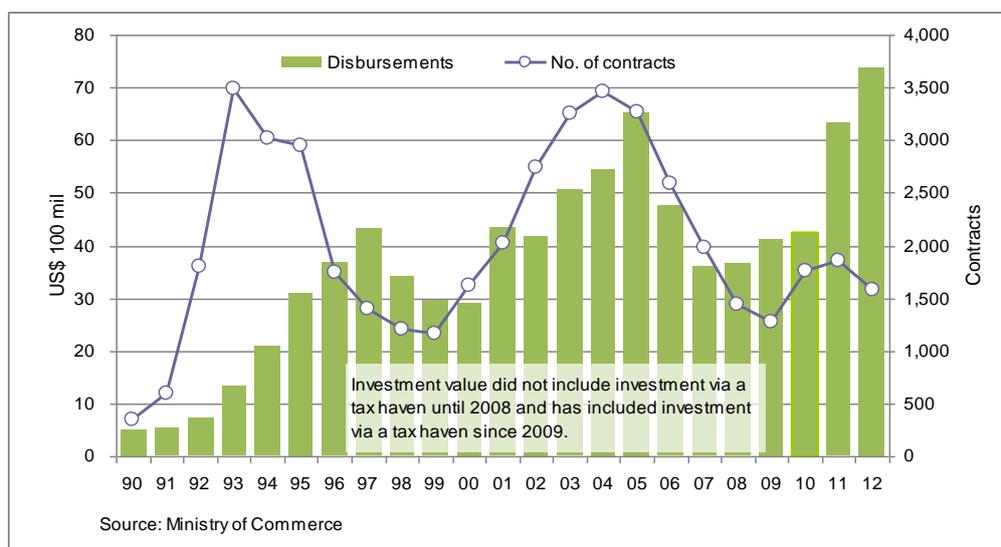
Statistics”, National Bureau of Statistics of China).

After a surge of investment in 2011 (up 78.4% year-on-year), the manufacturing sector significantly reduced its investment in 2012, showing an increase of 5.5% year-on-year. However, transportation machinery and equipment and electric machinery and equipment posted large growth with an increase of 90% and 30% year-on-year, respectively. The non-manufacturing sector showed growth of 10.6% year-on-year. Although the real estate sector maintained strong growth, the wholesale and resale industry, enjoying the largest share in non-manufacturers, experienced a sharp downturn after a sharp rise in the previous year.

Some said that Japanese investment in China would decrease after demonstrations in September. The amount of investment, however, started to increase in November and December after a drop in October and for the full year of 2012, it became clear that the investment had not decreased. But, if we assume there are time lags of several months before changes in investment conditions actually affect the amount of investment or the number of projects, we may consider that the impact of changes in investment sentiment of Japanese companies after September will emerge from now.

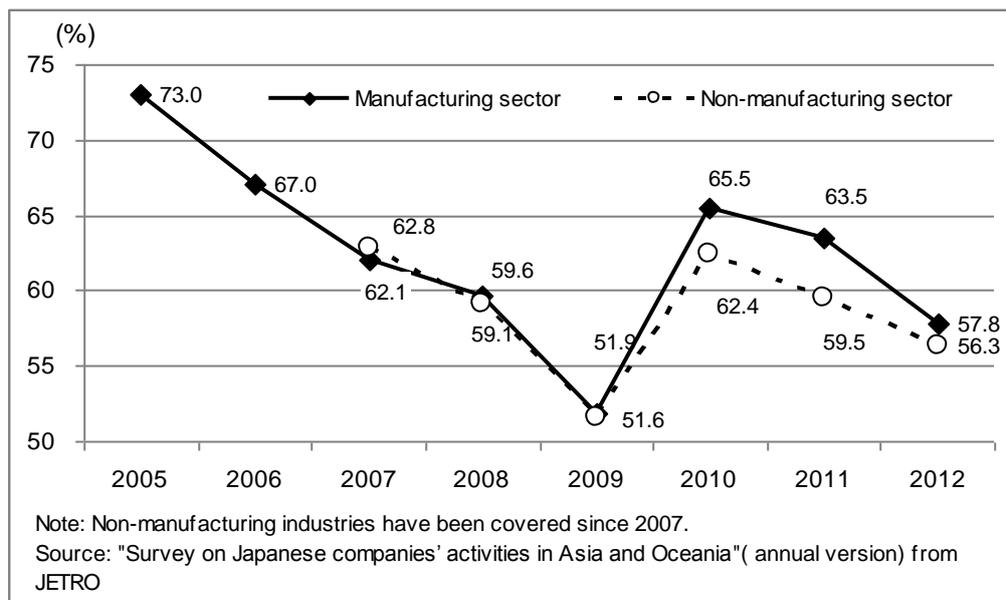
According to the questionnaire survey provided by JETRO in October and November 2012¹, with regard to intention of investing in China in the next year or two, the ratio of companies who answered they would “increase” their investment had been growing in recent years and reached 66.8% in FY2011 but in the FY2012 survey, it sharply fell to 52.3%. On the other hand, the number of those answering “maintain the status quo” rapidly increased to 42.0% from the 28.9% of FY2011. Thus, Japanese companies seem to be analyzing the current situation in a non-emotional manner.

Fig. 1: Trends in Japanese Investment in China



¹ “Survey on Japanese companies’ activities in Asia and Oceania in 2012,” JETRO (Number of surveyed companies: 1,268, response rate: 67.4%)

Fig. 2: Percentage of profitable Japanese companies in China



In 2010, the profitability of Japanese companies recovered to the level it was at before the financial crisis but since then, it has continued to drop, 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 borne by Japanese companies have rapidly increased. In response to aforementioned JETRO's questionnaire survey, most companies pointed out "rising personnel costs" as their main business issue, the same as the previous year. The response rate to this issue was prominent, at 84.4%, and it indicates the extent of this problem.

2. Major Proposals

Although points requiring improvement as requested by Japanese companies in China vary according to the industry, there are many common points. The following show the major issues and improvement requests regarding common problems in 11 areas including international trade and customs clearance, tax practices and accounting systems and labor. We present two types of requests: those which companies requested also in past white papers ("ongoing proposal") and those which are newly requested in this white paper ("new proposal").

Taking into consideration the current Japan-China situation, we created a new point of "Japan in the context of the Chinese economy" to make a much wider audience aware of the importance and contribution of Japanese companies to the Chinese economy and discussed the proposal based on the situation.

(1) "Japan" in the context of the Chinese economy

- Followed by worsening Japan-China relations, large demonstrations occurred over a wide range in the country. We strongly request that the Chinese government is committed to

maintaining good social order and ensuring that foreigners don't need to fear for their physical safety and contact us in advance wherever possible if they worry about the effects of demonstrations. [New proposal]

- It's most regrettable that the properties of certain Japanese companies were damaged by demonstrators. We ask the government to take the necessary measures to ensure such things do not happen in the future. [New proposal]

(2) International trade and customs clearance

- If regulations or systems associated with custom clearance are to be changed, we would like to be given a sufficient preparation period and be informed of the timing of disclosure and specific implementation procedures by such means as notices posted on the custom's website in advance. [Ongoing proposal]
- While the customs authorities have promoted paperless procedures for customs clearance of imports and exports, currently we can use this service only to a limited extent. We would like this service to be expanded so that we can use paperless customs nationwide in future. [New proposal]

(3) Tax practices and accounting system

- In terms of management of tax collection, we request tax practices which ensure a structure that helps taxpayers pay an adequate amount of tax, eliminates differences between regions and reduces room for regional tax authority's discretion wherever possible. [Ongoing proposal]
- The Chinese government switched its stance on investment to partially easing of regulations including an approval of RMB-denominated investment from abroad. However, the government still doesn't allow foreign companies to reinvest in China by converting funds denominated in foreign currencies to RMB in principle. This became a very high hurdle for foreign companies to reinvest in China. We request the government to lower the hurdle for reinvestment by promoting further easing of regulations. [New proposal]

(4) Labor-related issues

- Since the revision of the Labour Contract Act, in many cases practical interpretations or implementations vary regions. We request the competent authorities of labour and social security unify interpretations and implementations of laws and regulations wherever possible and present clear opinions while continuing to instruct and thoroughly implement such policies in every region. [Ongoing proposal]
- As the government introduced a social insurance system too quickly without clear detail regulations or deadlines, some companies are forced to pay delinquent taxes. In introducing the new system, we request the government keeps everyone informed about the system and provides sufficient training for in-charge persons to prevent different responses by each in-charge person. In addition, the new insurance system has many contents that overlap with social insurance policies that foreign companies took out outside China and foreigners don't

need many of them, with maternity insurance topping the list. This became an additional burden for foreign companies as they didn't include it in their initial budgets. We would like the government to review the social insurance system for foreigners. [New proposal]

(5) Intellectual property protection

- We request increased disclosure of trial decisions of the Trademark Review and Adjudication Board of State Intellectual Property Office and text announced by the People's Court. We also request a system that allows everybody to read materials of trials and courts, except for trade secret information. [Ongoing proposal]
- In order to defend against misappropriated applications for patent rights or trademarks, we request that misappropriated applications are added to grounds for refusal and invalidation. That is to say, we would like the government to specify that "those who acquire contents of invention or trademark illegally are not allowed to apply" in the patent law and the trademark law. [New proposal]

(6) Energy saving and environmental protection

- With regard to policies and laws, we continuously deem it necessary to develop implementation guidelines, define interpretations and clarify who is responsible. We request a tightening of control and strengthening of the penalty for companies that don't comply with regulations. [Ongoing proposal]
- Air pollution in urban areas is extremely serious. We want the government to take drastic measures including measurement and disclosure of air pollution data, identification of pollution causes and emission control. In addition, we would like Japanese companies to be allowed to participate in relevant projects such as introduction and spread of related technology and facilities. [New proposal]

(7) Engineering standards and certificates

- Some standards stipulate target values that are almost ideal values. Actual technological development should be taken into account in the planning stage. [Ongoing proposal]
- Security regulations on smartphones should be consistent with the global standard. The Chinese government requires compliance with China-specific specifications or standards as requirements for obtaining a network access license (NAL). However, we believe that it isn't adequate from the viewpoint of user protection. [New proposal]

(8) Technology and innovation

- In implementation of the approval criteria for high-tech companies in China, we request to more focus on the amount of R&D expenses. [Ongoing proposal]
- The concept of "Indigenous innovation" includes "Renovation." However, we have to say we are strongly against the idea that minor changes or modification of technologies invented in other countries become China-specific "indigenous innovation technology." We request the government to prevent deliberate use of the approval system of China indigenous innovation

products. We also request that the approval systems in local governments are consistent with the system of the central government. [Ongoing proposal]

(9) Domestic Logistics

- Rough-and-ready changes in regulations, systems, implementation or required documents will disrupt supply chains of manufacturers. The ratio of unpacking inspections at custom clearances significantly fluctuates depending on the political background and such behavior may have affected foreign company's motivation to invest in China. Therefore, we ask for sensitive handling. [Ongoing proposal]
- While the Electronic Data Interchange (EDI) has been promoted, we request a simplification of procedures and treatment of "correction." Followed by the expansion of EDI, we also request an enhanced backup system. [New proposal]

(10) Government procurement

- We would like the government to promptly enact and promulgate a series of relevant legal systems including "Enforcement Ordinance of the Government Procurement Act." We continuously request the Chinese government to listen to the feedback of Japanese industries. [Ongoing proposal]
- We request that China will accede to the CCRA (Common Criteria Recognition Arrangement), which is the mutual international recognition of certificates agreement for evaluation of Information Technology (IT) security products, and implement a mutually compatible system on an international basis as soon as possible. [New proposal]

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

- We request a revision of regulations on 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. [Ongoing proposal]

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.