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What's pushing Japanese firms out of China?

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In early 2015, Japanese companies, Panasonic and Toshiba, announced that they would stop producing television sets in China. As Japan continues to decrease its investment in China, the two multinational corporations' partial exit seemed to underscore an overall trend of Japanese firms withdrawing from China. On 23 February 2015, *Nikkei News* reported that Citizen Watch Company had suddenly closed down its parts factory in Guangzhou, laying off all 1000 employees there.

The Sino–Japanese relationship [1] has hit its worst downturn since normalisation of diplomatic ties. High-level dialogues, including summit talks, have been suspended since the Japanese government nationalised the Senkaku/Diaoyu islands in September 2012 and Prime Minister Shinzo Abe visited Yasukuni Shrine in December 2013. With its One Belt One Road strategy in 2013, Beijing launched its own diplomatic offensive to improve ties with neighbouring states, resuming intergovernmental contacts with Japan as well. But China has not shown any sign of compromise on the history or the Senkaku/Diaoyu issues. Meanwhile, Japan is moving toward its alliance relationship with the United States and has been developing a new collective security regime. There remains a deep-rooted mistrust between the two sides in both political and security areas.

It was against this backdrop that Japanese firms began to leave China. Despite the political predicament, its conditions in the labour market that have been the most important factor affecting these developments in the economic relationship between the two countries. Since large- and medium-sized corporations alike still yield profit in the market, the withdrawal of Japanese firms from China does not indicate dwindling business opportunities for all Japanese companies in the mainland.

Japanese firms entered China ahead of other countries after Beijing's reform and opening-up policy in the late 1970s. According to the Chinese Ministry of Commerce, by the end of 2012, 23,094 Japanese firms had set up in China. The current Chinese Ambassador to Japan, Cheng Yonghua, evaluates these firms' investment activities in China highly, stating that [2] 'by May 2015 Japanese accumulated investment in China had reached US$100.4 billion, making it the first country to surpass US$100 billion'.

But recently circumstances have changed for many Japanese firms, which have been in the Chinese mainland market for nearly four decades. Annual Japanese investment in China has decreased since 2012, when it peaked at US$7 billion. The amount in 2014 was US$4.3 billion, 38.8 per cent lower than the previous year. The business model in China has also started to change. Previously, foreign firms produced goods in China using abundant and cheap local labour, and sold their products to foreign markets. But increases in labour costs (particularly as a result of the 2008 labour contract law) have affected the profitability of firms seeking good returns. A survey [3] conducted by Japan External Trade Organization [4] (JETRO) shows that 83.9 per cent of Japanese firms believe that wage increases are a significant problem for their business activities in China.

On the other hand, expectations for China as a consumer market have been rising steadily among Japanese firms as Chinese purchasing power has increased dramatically in tandem with its booming economy. In 2014 the Japan Bank for International Cooperation raised its yearly evaluation of China from the fourth to third most promising destination for business activities in the mid-term (approximately three years in the future). Expectations for local market growth and current local market size were the top two reasons for the high ranking. Income growth has inevitably increased running costs, but at the same time, Japanese firms also see such growth as a positive factor for market expansion.

So while the amount of new investment from Japanese firms is decreasing, the Chinese market remains attractive.

Regardless of the political downturn, Japanese firms fare relatively well in the Chinese market. The Japanese Ministry of Economy, Trade and Industry notes that the total amount of sales by Japanese companies in China reached 36.4 trillion yen (approximately US$300 billion) in 2013 (over 44 trillion yen if Hong Kong is included) only one year after the nationalisation of the Senkaku/Diaoyu Islands.

Japan's core businesses are gaining footholds in China. Sales volumes in 2013 for automobiles, data communication and electronic industries were 9.4 trillion, 3.9 trillion and 2.2 trillion yen (approximately US$80 billion, US$30 billion and US$20 billion) respectively. Japan's multinational corporations, such as Toyota, Nissan, Honda, Hitachi and Panasonic, sell products valued at more than 1 trillion yen in this market, and they only expect that to grow.

Most importantly, Japanese firms believe that the Chinese market will continue to expand, and they are confident about generating profits there. In JETRO's yearly survey in 2014, 64.1 per cent of Japanese firms replied that they expected profit from sales, an increase from 60.7 per cent of firms on the year before.

The idea that all Japanese firms are on the way out of China is a myth. For Japanese companies, China's role has changed from 'the factory of the world' to 'the market of the world', as Chinese wages and consumption trend up.

China's rise has forced structural change within the international community, and with it a deteriorating political and security relationship with Japan. Realists argue that Sino–Japanese confrontation in the political and security realms will likely adversely affect their economic ties as well. In contrast, liberalists predict that mutual economic dependence between the two will eventually contribute to stability in their political relationship.

It is true that the politics of the bilateral relationship have not always been positive for Japanese firms operating in China. Yet Sino–Japan relations are not easily described by either the realist or liberalist paradigms. The relationship, characterised by 'cold politics, hot economics', is an interesting case study in international relations in an era of globalisation, the nature of which is unprecedented. For now, confrontation in the political and security sphere continues to appear compatible with deep interdependence in the economic sphere.

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[1] Sino–Japanese relationship:
http://www.eastasiaforum.org/2015/09/28/the-geo-economic-potential-of-the-china-japan-relationship/

[2] stating that: **http://www.china-embassy.or.jp/chn/sgxxs/t1280363.htm**

[3] A survey:
https://www.jbic.go.jp/wp-content/uploads/press_en/2014/11/32994/20141128English1.pdf

[4] Japan External Trade Organization:
http://www.jetro.go.jp/ext_images/jfile/report/07001901/07001901_01a.pdf#search=

[5] East Asia Forum Quarterly: **http://www.eastasiaforum.org/quarterly/**

[6] Japan-China relations:
http://press.anu.edu.au/wp-content/uploads/2015/09/WEB-final-EAFQ-7.3.pdf