A round-table discussion:

Chindia's economy amidst the global financial crisis

〈Panel〉

China
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Indina
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Q: What is the current status of Chindia's economy amidst the global financial crisis?

Choi Yong-min: Is the Chinese economy in crisis at the moment? Let us take a look at the indicators. China's exports in July increased by only 1%; this is the smallest increase since November of 2009. Foreign direct investment has also declined this year. The investment increase rate for non-current assets fluctuated between 24% and 30% between 2003 and 2011, but the rate is about to fall below 20% any time now. Consumer spending, China's biggest concern, increased 13.7% in June, far lower than the 21.5% increase during the 2008 financial crisis. However, China has the means to overcome this crisis. Commodity prices are stable, and China's broadest measure of money supply, M2, was up 13.6% at the end of June, compared with a year earlier. This increase is far smaller than the 27.7% increase in 2007. The real estate fervor has cooled down. China's fiscal deficit is only 1% of GDP, and it also has ample government deposits. What I want to emphasize here is that an economic growth rate of 7% is not a determinant of a financial crisis. This is just China's normalized economic growth rate.

Cho Choong-jae: India's economic slowdown can be explained by four highs: high inflation, high interest rates, high fiscal deficit, and high foreign exchange rates. We cannot expect global cooperation in the European sovereign debt crisis as there was among the G20 in the 2008 financial crisis. In particular, India has little room to increase fiscal expenditure. Now, cutting interest rates is the only plausible means, but this would not work well due to inflation pressures, a major challenge facing the Indian economy. As foreign investment has been flowing out of the Indian stock market until recently, foreign exchange rates have surged. The sharp increase in foreign exchange rates worked as pressure for import prices to rise, which makes it difficult to cut interest rates. Moreover, as monsoon rainfalls are insufficient for cultivation, and global food prices are rising, interest rate cuts are being delayed. If the European crisis remains unchanged and the central bank starts cutting the benchmark interest rate, the Indian economy would recover faster than expected, as it did after the 2008 financial crisis.

Park Hyun-chae: The question, "Can India overcome the current financial crisis?" naturally leads to the question, "Are India's fundamentals strong?" As we now live in an era of knowledge industry, talent pools are important. In this sense, India has many advantages. India has a talent pool, as one can

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easily guess from the fact that it is one of the three countries in the world that can make supercomputers on its own, and its capacity to develop software is the second highest in the world after the USA's. Also, India's dependence on foreign trade is around 30%, far below China's 50% and Korea's 97%. Taking these factors into account, the Indian economy will have a difficult time for a while, but it can overcome the crisis in the medium- to long-term.

Chung Sang-eun: The Chinese government seems to have learned many lessons from the 2008 financial crisis. During the 2008 crisis, China enjoyed continuous economic growth thanks to its RMB 4 trillion stimulus package, but it paid the price. China suffered inflation, an oversized public sector, a widening gap between the rich and poor, a deteriorating private sector, and local governments' fiscal delinquency. Therefore, in response to the current financial crisis, China is spurring restructuring, to which it had previously paid little attention. Rather than a massive stimulus package, China has opted for interest rate cuts that are barely sufficient to protect the economy from dramatic fluctuations.

Moosup Jung: The Indian economy declined in the first quarter of this year because the government raised interest rates the previous quarter. Underdeveloped economies, such as India's, are easily influenced by interest rates. India is rather unlucky. Insufficient monsoon rains influence food supply, and reduce income, which leads to reduced consumption. They also restrict hydroelectric power generation. The Indian economy is expected to have low growth for a while. Then, inflation will ease. When we take it positively, rupee depreciation increases foreign investment. The service balance and balance of transfer are surging. India's foreign exchange authorities seem to keep the rupee depreciated. If private funds complement insufficient government financing of infrastructure construction, India could show signs of recovery next year. Due to such innate factors, the Indian economy looks good in the medium- to long-term.

Kim Dong-ha: Aside from fiscal policy, China has many means of tackling the recent financial crisis, such as expanding domestic demand through urbanization, tax cuts, inducing yuan depreciation, and supporting export companies. This year, China gave up baoba (保八), a term that describes the 8% annual economic growth rate that officials believed was critical to ensuring social stability, and set a new target of 7.5%. Therefore, China will not resort to a huge stimulus package this time, as it did in the 2008 financial crisis, when its RMB 4 trillion stimulus package resulted in many side effects. China is now pondering different methods, such as increasing investment in the private sector and expanding tax cuts. In July of 2012, China released a new set of guidelines to promote domestic private investment, the New 36 Articles. In the second half of this year, China will expand tax cuts in order to encourage private investment.

Lee Chi-hun: The possibility of a hard landing is very low in both China and India, but the risk of an economic downturn and a slow recovery is very high. In particular, with insufficient fiscal capacity and high inflation, India has little room to tweak policy in response to an economic downturn. This means that India has a higher risk of economic slowdown than does China. The reason India has a lower risk factor than China is that its export-to-GDP ratio is 14.2%, far lower than China's 26%. Therefore, India is less influenced by external shocks than is China. With declining potential growth rates, China and India will likely face a W-shaped recession, in which they will recover slowly in the second half of this year, before falling again in the second half of next year.

Q: For how long will the Chinese government's control and social stability last?

Chung Sang-eun: The Chinese Communist Party (CCP) is maintaining control, but its logical validity is diminishing. In order to keep control, the CCP should help the public increase incomes and solve many problems, such as the widening gap between the rich and poor, corruption, privatization of state-owned enterprises, high unemployment, and insufficient social security. The CCP lacks the ability to solve all of these problems. Quite the opposite, it is being criticized as the main culprit behind these problems. However, the situation is not so dismal as to cause dramatic political changes or turmoil. The problems will come to a head around the time that Xi Jinping (習近平) wins his second-term. If incomes continue to rise, problems are sure to follow.

Lee Chi-hun: The Chinese government's control is unlikely to collapse in the short-term as happened in the Middle East after the Jasmine Revolution. However, social instability will likely become a serious problem in the long-term. Among the many reasons for social unrest, complaints about economic disparity are especially likely to surface, aided by widespread use of the Internet. Inequality in education and health care under the *hokou* (戶口) system is also a serious social issue. Even though the Chinese government understands the gravity of the situation, the current Chinese political structure makes it difficult to address the issues. Social unrest will surface in the next five to ten years.

Kim Dong-ha: I believe that the Chinese government will properly respond to the current crisis, but it will face new challenges in the medium- to long-term. First, the advantage from its huge population will end. China's population is aging, so it will be difficult to achieve growth rates as high as those achieved in the past. Second, unemployment of migrant urban workers is serious. More than 20 million of China's 120 million migrant urban workers have been laid off as a result of the recent economic slowdown. What is worse, these people create social unrest after returning home and finding no jobs. Third, a record 6.8 million college graduates, the first from the "post-1990" (90后) generation, born in the 1990s, will enter the workforce this year. Recent economic instability has caused many jobs to be lost. Massive unemployment among the new generation is a challenge that the Chinese government has never experienced before.

Han Gwang-soo: Koreans living in China have different opinions about China from people in Korea. China is not as unstable as Koreans worry. Rather, Chinese people worry that Korea does not have adequate solutions to current problems. Different opinions about China will create inefficiency in Korea's approach to China in the future. Therefore, a logical and analytical approach is all the more necessary for Korea. We need to look at China from a balanced, broad perspective.

Q: India's politics and social infrastructure are dragging down the economy. Is there any solution?

Cho Choong-jae: Many problems in India, such as corruption, taxes on foreign companies, and land acquisition clashes, are both structural problems and growing pains. It is difficult to solve these problems quickly, but these ongoing problems are working positively by advancing transparency, legislation, and institutionalization.

Moosup Jung: In India, the public sector is dragging down the private sector. India has a high degree of media presence. The private sector and the media have been working hard to transform the government, as India becomes a more rational and transparent state. Recently, excessive taxes on foreign firms became a hot-button issue; however, the country's general attitude toward the government's foreign investment policies is positive. In India, there is no discrimination against foreign companies in the manufacturing sectors, such as the chemical and automotive sectors.

Park Hyun-chae: To overcome the current crisis effectively, India needs to quickly address three major problems—corruption, bureaucracy, and inadequate infrastructure—in order to transform itself into a country with a better business environment. India should more strictly enforce laws on government officials and entrepreneurs connected to corruption. India should revise exponentially increasing government subsidies and improve infrastructure to attract more foreign investors. India should nurture industries with high potential, such as tourism and distribution. In addition, India must actively seek free trade agreements with foreign countries in order to further develop the software and pharmaceutical industries, in which it has a competitive edge in the global market.

Kim Chan-wahn: India has a population of 1.2 billion people, and 1.2 billion problems. Bihar is the most backward state, but recently it is growing the fastest among Indian states. Its infrastructure is still backward, and foreign investment has not picked up. However, Bihar is growing very quickly because the local government has changed. With better governance, India can realize more of its potential. Indian people see a bright future. They have high expectations for the newly-elected Finance Minister-turned President. Considering India's weak manufacturing sector, the Indian government is actively supporting information technology and bio technology at the national level.

Q: With what strategies do companies in Chindia respond to the global economic crisis? And what are the strategies of Korean companies?

Cho Choong-jae: Some Indian companies are now taking action in order to make the most of the depreciation of European assets. In particular, Infosys and TCS are actively trying to acquire prestigious European IT firms to expand their presence in the European market. In the past, Hyundai Motors and LG Electronics entered the Indian market through sole ventures and large initial investments, but now those strategies might not work well. For smooth land acquisition, Korean companies might choose M&A's and joint ventures over green field investment. In economic cooperation between Korea and India, investment especially by Korean small- and medium-sized enterprises in India, should be promoted. In this sense, it is very important to develop an industrial complex exclusively for Korean SME's. Recently, Japan is actively utilizing its own industrial complex for Japanese companies, and entering India through M&A's.

Park Hyun-chae: Indian companies in the telecommunications and pharmaceutical industries are competitive. They seek growth through M&A's. In particular, companies in the steel and telecommunications industries are actively buying European companies. Indian pharmaceutical companies pursue marketing by acquiring companies from Europe, the USA, and Japan. They even conduct field surveys to enter the Korean market. The Indian domestic market keeps developing. However, agricultural products require more investment because India has a substandard distribution system, despite its high agricultural output.

Moosup Jung: Indian companies depend on imports of raw materials and facilities. India cannot afford to invest in facilities due to exchange rates. Its industrial production in the second quarter was poor because the country deferred investment in facilities. If interest rates start to decline, there will be investment in facilities. Encouraging domestic consumption, especially by the low-income population, may have a positive outcome. In the information and telecommunications technology sector, a crisis may turn into an opportunity thanks to the effects of cost saving and outsourcing. Foreign companies' rush to enter the Indian market did not subside due to the depreciation of Indian assets. Foreign companies in India depend increasingly on local procurement.

Kim Chan-wahn: India should begin locally sourcing parts for which it is highly dependent on imports. Mergers and acquisitions of local assets and vertical integration are plausible. India should also invest in real estate. India is expected to invest about USD 1 trillion in infrastructure. Various businesses of Japanese companies and other global companies, including Siemens and GE, are entering the Indian market at the same time. They need to form clusters in each region to share information and buildings. The Korean government should assist Korean companies in entering India.

Park Hyun-chae: Korean companies need to establish a hub for research and development in order to expand their B2C model in response to the growing Indian middle class, and make the most of India's engineering talent pool. Foreign companies' investment in India is mainly focused in service and telecommunications. Aside from investment in the traditional manufacturing sectors, such as the automotive and electronics sectors, Korean companies should diversify investment in services to target India's domestic market. Korean companies should expand investment in India to utilize the country as a springboard into Africa. At the same time, they need to find a different angle on entry into India, such as developing products for

India's bottom of the pyramid (BOP) market, and targeting the global market with such products.

Kim Dong-ha: The Chinese government's prescription to local companies responding to the recent financial crisis is summarized in two parts: prepare for a prolonged war and strengthen risk management. A model case of heeding this prescription is Sany Heavy Industry's layoffs. Sany is China's largest heavy machinery manufacturing company, with a global workforce of 60,000 and more than RMB 50 billion in sales in 2011. The state-owned company began laying off its workforce earlier this year due to falling demand and the financial crunch. The layoffs have been well received in China as a preemptive measure. This is in stark contrast to the past, when the country mainly criticized layoffs. This can be interpreted as the Chinese government sending a new signal to businesses, encouraging local companies to boost their medium- to long-term responsiveness to the recession. Chinese firms recognize well that the era of profits as high as 10% is already over. They all agree that they need to have countermeasures to be prepared for the next three to five years.

Chung Sang-eun: Korean companies should carefully examine the changes in Chinese companies' management strategies, and take the outcomes as guidelines for setting strategies regarding China and global management during and after the financial crisis. Considering that a crisis often turns into an opportunity, Korean companies should be determined and ready to take on any profitable business. If they have an opportunity in India, they should take that opportunity, even though it is not their core business.

Lee Chi-hun: Korean companies should respond to the Chinese government's policies flexibly when entering the Chinese market. They should enter the Chinese market with high value-added goods and services in line with China's policies for industry sophistication. Korean companies should actively examine entry into China through M&A's in response to China's policy of privatizing state-owned companies. Korean companies should try to improve investment efficiency by the sharing of information and other benefits, through the "fleet-style" market entry strategy, wherein big and small companies put their heads together to plan their entry strategies from the very start, and the "chain" strategy, wherein related companies jointly enter foreign markets. C

Chinese firms catch an opportunity from the global financial crisis

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Sany Heavy Industry (三一), China's largest heavy machinery manufacturing company, recently announced that it would cut 30% of its workforce. The Chinese government, which is sensitive to employment indicators, has atypically praised the cut as a model of restructuring.

Sany Heavy Industry has the largest market share in China's ready-mixed concrete and excavator markets. Sany was the first company to supplant Doosan Infracore at first place in the Chinese market. Since its establishment in 1994, Sany has achieved a growth rate above 50% each year and become the leading company in the industry, with RMB 50.8 billion in sales and 20% operating profit (RMB 10 billion). Even during the global financial crisis in 2008, Sany reported an increase of 58% in sales. Is the recent financial crisis so severe in China that even Sany resorted to personnel cuts? Sany bought German concrete pump maker Putzmeister earlier this year. Despite help from the Chinese government, this was too big an M&A for a faltering company that was forced to reduce its workforce. How do we interpret Sany's contradictory moves and the Chinese government's response?

Chinese firms' responses differ between the 2008 and 2011 crises

Sany's recent moves are representative of Chinese companies' response to the European financial crisis, which started in the second half of 2011: seeking solid management through workforce reduction within, while actively making external moves, such as export expansion and M&A's with advanced foreign companies. The Chinese government unveiled a RMB 4 trillion stimulus package immediately after the 2008 global financial crisis; however, there was no such move after the recent financial crisis. Perhaps the Chinese government concluded that the massive stimulus package did more harm than good. Even though China maintained its high economic growth thanks to the RMB 4 trillion stimulus package, it also suffered many side effects: an overheated real estate market, inflation, bankruptcy of local governments, oversized state-owned enterprises, and a widening gap between the rich and poor. Learning lessons from this experience, China seems to be taking the recent crisis as an opportunity to improve efficiency across its economy by utilizing institutional measures to control the economy, such as cuts in the reserve requirement ratio, rather than large scale and artificial stimulus support, together with companies' own measures for restructuring. In this sense, Chinese firms' response to the recent financial crisis is quite different than it was to the previous financial crisis, when they had been solely dependent on the government's stimulus measures.

Utilizing the Chinese government's stimulus package

The recent financial crisis has dealt a lethal blow to China's small private exporting companies. These companies, which had difficulty with rising labor costs and raw material prices, suffered from plummeting orders from the EU, the largest export destination. It was as if their lifeline had been cut. As small exporting companies have become financially distressed since the second half of 2011, many such companies in provinces like Guangdong and Zhejiang, where many exporting companies are concentrated, have gone bankrupt. A series of cases have occurred where presidents of small and medium-sized enterprises (SME) failed to pay back bank or private loans and absconded overseas overnight, causing a serious social problem. To solve the problem, the Chinese government unveiled measures to expand loans to SME's in October of 2011, and one month later, Premier Wen Jiabao visited Zhejiang and Wenzhou Provinces to encourage the local governments to increase financial support to SME's. The Chinese government has also announced a variety of stimulus measures: three cuts in reserve requirement ratios since December of 2011, two cuts in interest rates, RMB 26.5 billion worth of subsidies for energy efficient home appliances for one year from June 1, 2011, and large-scale public projects. These measures were not as grand as the stimulus package of 2008, but some measures tailored to exporting SME's deserve attention. The Chinese government decided to allot 30% of government procurement to local SME's this year. China depreciated its currency by around 1% against the dollar this year, after a 4.7% appreciation last year. Eyes are on this currency depreciation because it is one of the few stimulus measures taken by the Chinese government in response to the recent financial crisis.

Restructuring boosts competitiveness

Beyond government support, Chinese companies are increasing their competitiveness through restructuring and layoffs. In addition to Sany, major Chinese companies including Medea Electric Limited (美的), BYD Auto, and ZTE (中興通信) are laying off huge numbers of employees. Since the end of 2011, Medea, China's largest air conditioner maker with RMB 140 billion in sales, has slashed 30% of its workforce, which stood at about 90,000 at the end of 2010, to 70,000 workers. ZTE, the world's fourth largest mobile phone maker, has cut 10,000 employees, while BYD Auto, the largest Chinese auto brand, has cut 5,000 employees. Moreover, LDK, the world's fifth largest solar panel maker, has slashed 5,000 workers, while textile and leather supplier Huaxi Group (華西) has laid off 1,000 workers, 60% of its total workforce. These companies resorted to downsizing mainly due to poor performance, such as falling sales and rising outstanding amounts; however, problems in their own structures, such as over-employment, were also significant. Medea benefited most from the government subsidies given to rural communities in 2008 for purchasing home appliances (家電下鄕). In 2009, at the peak of the policy, Medea's workforce totaled 200,000. In the meantime, labor-intensive companies, including Huaxi, are actively seeking facility mechanization and automation, rather than trimming workforce, to tackle rapidly rising labor costs.

M&A's turn crisis into opportunity

Despite the global economic slowdown, Chinese companies are on a domestic and overseas M&A spree. They are especially targeting European companies at discount prices after the European economic crisis. Sany bought Germany's largest concrete pump maker, Putzmeister, for EUR 570 million. Putzmeister has been leading the concrete pump manufacturing sector for decades. The company was an ideal target company for Sany, which has set a world record for vertical pumping height at 492 meters. Chinese auto parts maker Hebei Lingyun Industrial Group has acquired its German peer Kiekert.

Chinese companies are eyeing European companies because many European companies are for sale at low prices, and brand power and technology are attainable at the same time. It is noteworthy that Chinese firms are especially interested in buying world-class German companies, which will help them boost technology and trust in one stroke. This is in stark contrast to their M&A's after the 2008 global financial crisis, when they bought hollow US companies for scrap values.

Companies will become more competitive as they tackle the crisis, and troubled companies will be nudged out of the market, making the fundamentals of China's economy stronger.

CITIC Securities, China's largest securities firm, has sealed a deal to buy Hong Kong-based brokerage CLSA Asia Pacific Markets from its struggling parent, France's Credit Argricole SA. The China National Offshore Oil Corporation (CNOOC) has agreed to buy Canada's Nexen for USD 15.1 billion in the biggest overseas takeover by a Chinese company. These two M&A's are examples of China's active moves to improve the competitiveness of its less competitive sectors, such as state-of-the-art technology, finance, and natural resources.

Chinese firms go global and seek new markets

Chinese manufacturers are offshoring plants to Cambodia, Bangladesh, Myanmar, and Indonesia in order to avoid rising labor costs and land prices in China. Fourteen Chinese companies are already located in Sihanoukville, a port city in southern Cambodia, creating a Chinese industrial complex. China's biggest online apparel retailer, Vancl (凡客) has decided to increase production in Bangladesh, which has low labor costs, and is actively examining relocation of its production bases to Southeast Asia. Vancl stated that it was difficult to maintain production facilities in China, as the monthly salary of a Bangladeshi worker is around RMB 500, while a Chinese worker is now paid at least RMB 2,000 per month. China's average monthly pay for urban migrant workers under 35 was RMB 2,513 in 2011, a 30% increase from 2009. Chinese manufacturers, especially in light industries such as clothing and textiles, will speed up their relocation overseas. With labor costs skyrocketing in China, overseas production is more profitable despite shipping expenses.

Chinese firms are redrawing their export map, expanding from the USA and the EU to Latin America, Africa, and other regions. China's trade with Latin America grew 113% from 2009 to 2011, and its exports to Latin America totaled USD 241.5 billion last year. China Confidential predicted that Latin America will become China's largest export region around 2017 due to the rising demand for Chinese products by the middle class in Latin America. Changhong Electric (長虹) exports most of its PDP TV's to South Africa. Polaris Jewellery's exports to Russia totaled USD 35 million last year, three times bigger than its USD 10 million in exports to the USA. Chinese manufacturers are performing well in the emerging markets not only with consumer goods, but also with construction equipment and other heavy industries. China's exports of heavy equipment to emerging countries grew by 25% annually on average from 1998 to 2010, thanks to its increased investment in emerging markets. As Chinese firms have expanded investment in Africa, China's exports of capital goods, such as goliath cranes for construction, are also rising.

Post-crisis responses

All things considered, the recent crisis poses risks to China's economy and to Chinese companies; however it also provides opportunities. Of course, China will face massive layoffs, an economic slowdown, and other troubles in the process of overcoming the crisis; however, given that the Chinese government has the means and capability to ward off severe economic slowdown, China's economy will not fall into a downward spiral. Rather, companies will become more competitive as they tackle the crisis, and troubled companies will be nudged out of the market, making the fundamentals of China's economy stronger.

It will no longer be the case that China's huge stimulus packages will serve as a driving force of recovery from global economic crises. If the current crisis becomes more severe, the Chinese government will have to implement massive stimulus packages, but there has been no sign of this. Korean companies should carefully examine what strategies Chinese companies have adopted in responding to the global economic crisis, and take the outcomes as guidelines for setting strategies regarding China and global management during and after the financial crisis. C