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China meets the challenge of a global slump with a stimulus plan to kick-start its economy.

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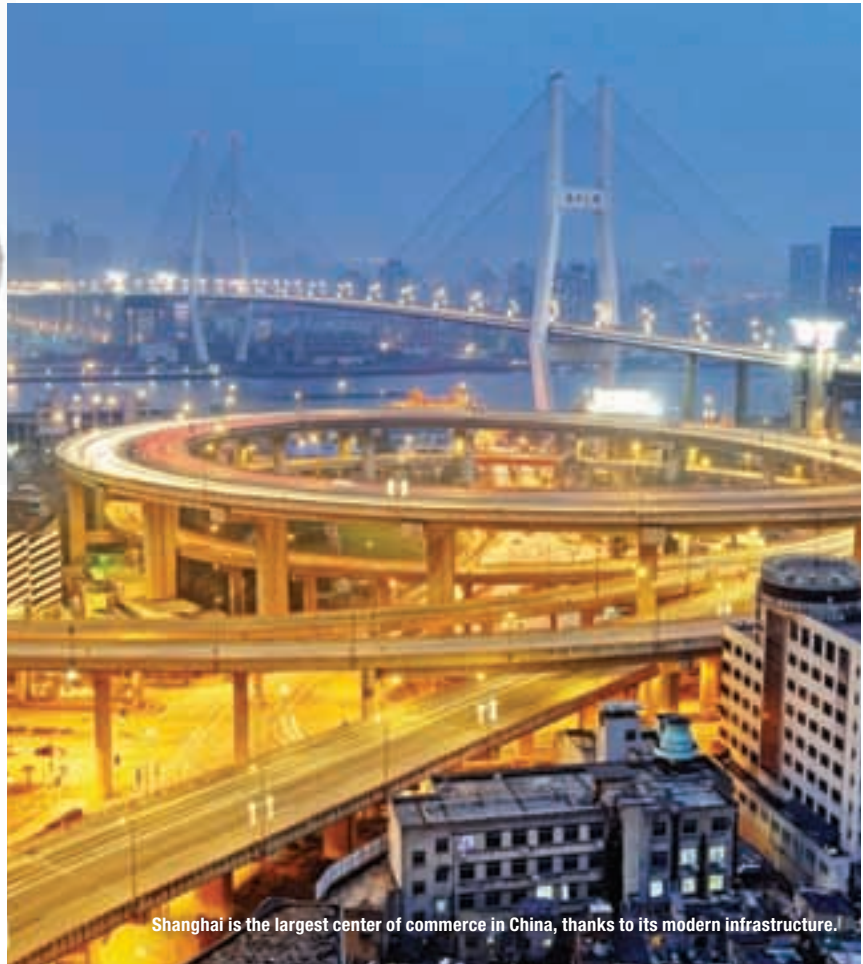


China

has responded to the effect of the world economic slowdown with en- viable panache. Although exports plunged last year and millions of migrant workers went home to the countryside, China's government is forecasting 8% GDP growth in 2009. A first-quarter score of 6.1% indicates that the nation—aided by a far-reach- ing economic stimulus package—may be on its way to reaching that goal.

While GDP growth has stalled or fallen in most advanced industrialized countries during the global economic crisis, 8% would signal the slowest growth China has endured in a decade. In 2007, the economy swelled at a 13% rate, and in 2008, even as the world economy began to suffer the effects of the financial meltdown, the Middle Kingdom managed to eke out a 9% in- crease, its lowest since 2001.

China's climb to the No. 3 economy in the world, after the United States and Ja- pan, may be the fastest such ascension in history. The world's most populous coun- try remade itself by averaging real GDP growth of almost 10% a year since mar- ket reforms were launched in 1978. But by becoming the world's factory, China also exposed itself to the fluctuations of the global economy. As demand from China's major markets in the U.S. and Europe collapsed last year, export growth slowed by a third to \$1.4 trillion, still \$200 billion more than in 2007.



Shanghai is the largest center of commerce in China, thanks to its modern infrastructure.

Last fall, China's central government responded to the global slowdown with a \$585 billion stimulus package designed to keep the economy growing. A lot of the money has been poured into infra- structure: railroads, highways, bridges, and airports. "Many economists say that China is the gold standard in stimulus packages," says John Frisbie, president of the U.S.-China Business Council (USCBC), an association of 220 U.S. companies that do business in China. He adds that the plan may offer great opportunities for foreign equipment manufacturers whose own domestic markets have slumped, es- pecially markets related to infrastructure.

One reason for China's resilience, some economists say, is that the coun- try is less dependent on the export market than is commonly assumed,

because relatively little value is added to imported products on China's assem- bly lines. "China is not an export-led economy; it is a continental economy driven primarily by domestic investment and consumption," says Andy Rothman, China macro-strategist for CLSA Asia- Pacific Markets, a brokerage firm based in Hong Kong. His firm reported in May that manufacturing demand was up for a second consecutive month in China, driven largely by domestic consumption.

Despite China's relative success in weathering the economic storm, the country's leaders seek to reduce future vulnerabilities and want to grow a more robust service sector. Up to 70% of GDP in advanced countries depends on ser- vices; in China it's just 40%. In February, the central government ordered various

A Global Showcase

At 52, the China Import and Export Fair has become one of the world's grandest events.

In this vast land of 1.3 billion people, everything is done in a grand manner. Remember the more than 15,000 who performed at the opening ceremonies of the 2008 Summer Olympics in Beijing? The China Import and Export Fair, also known as the Canton Fair, is no exception. This twice-a-year exhibition has gotten so huge that the spring and autumn sessions are each divided into three phases, each lasting five days, to accommodate the tens of thousands who want to exhibit their wares in the cavernous Lihua Complex in Guangzhou, capital of Guangdong Province in southern China.

This year's spring exhibition—the 105th fair—featured nearly 56,000 booths set up by more than 22,000 Chinese manufacturers who took turns occupying 1.1 million square meters of exhibition space over two weeks. The event, which ended May 7, attracted more than 165,000 overseas buyers, including 9,035 retail chains and other businesses from the United States. The 15-day session generated \$26.2 billion worth of export contracts—the equivalent of 11% of the \$245.5 billion that Chinese companies exported in the first quarter of 2009.

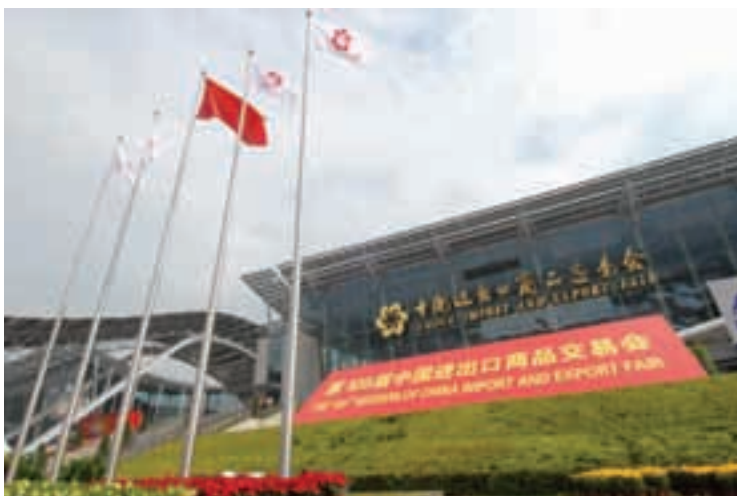
Huge as they are, the numbers are actually smaller than those generated at the previous session last autumn. "A modest decline of 5.2% was seen in the number of overseas buyers," says Mu Xinhai, the fair's deputy secretary general. Export sales were down 16.9%, which is not surprising given the global economic crisis and H1N1 swine flu problems in Mexico, the U.S., and other countries this spring. "In all, everything went well in a balanced way," reports Mu, "with better-than-expected results, which made great contributions to stabilizing foreign trade, maintaining economic growth, expanding domestic demand, and adjusting the economic structure."

Jostling for Attention

Launched back in 1957, the Canton Fair mirrors China's journey from basic manufacturer to the value-added export powerhouse it has become. At the latest exhibition, luxury Zhonghua sedans and snazzy Loncin Group motorcycles jostled for attention alongside gigantic flat-panel TVs, computers, and other consumer electronics. Export orders for machinery and electronic products topped \$11.3 billion, nearly half the total, followed by light industrial products (\$8.4 billion) and textiles

and garments (\$3.2 billion). An e-business platform called Canton Fair Online, a recent addition, had 190 million visits during the Fair, up 2.5% from last autumn, although online orders fell 13.7% to \$510 million.

The spring fair was a buyer's market. Five years ago, suppliers declined to accept orders for fewer than five container loads, a foreign visitor told a Hong Kong newspaper. Now, they are willing



The Canton Fair is a magnet for international investors.

to accept just one. Prices were generally lower, as well, as manufacturers passed the falling costs of materials, labor, and other expenses on to customers. Fair organizers also rolled out a plusher red carpet: a newly established customer service center helped trim the number of complaints to a fifth of last autumn's total.

Buyers will be expecting the same level of service, wide range of products, and attractive pricing at the 106th Canton Fair, which will run from Oct. 23 to Nov. 4 this year. The autumn event will be closely watched for another reason: Given China's central role in international trade, the volume of export orders will indicate whether the hints of economic recovery being seen today will produce more buying for the Christmas season, confirming hopes of a turnaround in the world's economic fortunes in 2010. ●

ministries to promote the development of the service sector in 20 Chinese cities. As incentives, the government offers a 15% corporate tax rate for enterprises that enter the sector, zero sales tax on outsourced services, and a \$658 subsidy for the salary of every college graduate signed to a one-year contract.

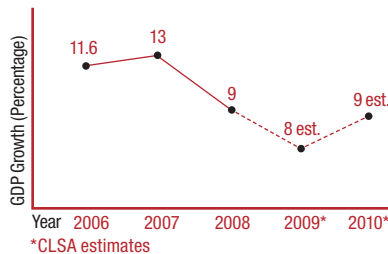
Special enterprise zones that have traditionally hosted domestic and foreign manufacturers are also turning their attention to services. "Our focus is manufacturing," admits Ni Xiang Yu, vice chairman of TEDA (Tianjin Economic-Technological Development Area), located near China's third-largest city. TEDA hosts Toyota, Samsung, Motorola, and 4,600

step in China's efforts to strengthen its economy. Some foreign experts propose a more ambitious "rebalancing" that includes liberalizing the financial sector and promoting higher consumer spending. CLSA's Rothman believes the government must provide more security before China's tight-fisted consumers loosen their purse strings. On average, Chinese consumers save around 25% of their income; the national savings rate is 47% of GDP. "Chinese households have been taxing themselves with a high savings rate to compensate for the absence of a formal social safety net," he says. "They save to ensure they have funds for education, health care, and

Texas manufacturer of valves and flow-control equipment, announced in March that it had formed a joint venture with China's largest valve maker, Sufa Technology Industry Co. The new venture will manufacture products exclusively for China's growing nuclear power industry.

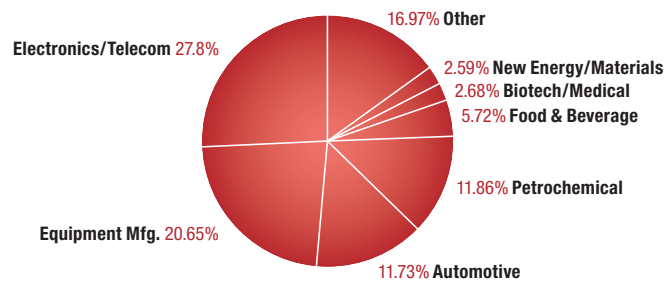
John Frisbie of the USCBC says China will continue to be an important business partner for U.S. companies after the global recovery. "The U.S. and China are already greatly interdependent," says Frisbie. In a survey last year, 88% of his members indicated they were turning a profit in China. Frisbie says USCBC has so far been encouraged by the Obama administration's approach to its third-largest

China's Economy: A Quick Rebound?



Source: 2006–2008 OECD Economic Outlook; CLSA Asia-Pacific Markets

TEDA's Industrial Output



Source: TEDA Report Q1 2009

other foreign manufacturers, "but we welcome tertiary industries like banking, insurance, and financial services."

Foreign companies in China are already finding opportunities in services. Amdocs, based in Chesterfield, Mo., won a contract in January to provide customer management and billing services to China Telecom's 35 million mobile phone subscribers. The world's largest landline company (220 million customers) acquired a wireless arm when the government rejiggered the world's biggest cellphone market (600 million customers). Job Brokers, a Tempe, Ariz. employee recruitment firm, announced in April that it would open an office in Beijing to serve U.S. companies operating there.

The renewed focus on services is one

retirement." It will take years, Rothman believes, to create a system that is well-funded and trusted.

Nicolas Lardy, senior fellow at the Peterson Institute for International Economics, says manufacturers in China have a low tax burden. Although profits are up, most enterprises pay no dividends to their owners. "As a result, businesses have a lot of retained earnings, all of which are reinvested," says Lardy. "Some of that should be taxed away to reduce the rate of investment, which is an important part of rebalancing."

China's vast domestic market retains its appeal to foreign manufacturers. Foreign direct investment rose 23% to \$92.4 billion in 2008 despite the global slowdown. For example, FlowServe, an Irving,

trading partner. "America's current economic challenges may cause temporary shifts in U.S. trade with China, but the long-term trends are clear—and the need for a clearheaded, stable approach to China is more important than ever."

A lot of the focus in the past has been on imports from China, says Frisbie, but the economic slowdown has made Americans aware of another aspect of U.S.-China trade: "There's a realization now that we also sell a lot of products to China." In 2008, according to USCBC, U.S. exports to China totaled \$71.5 billion.

—Joel Dreyfuss

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China's Boomtown

For a glimpse of one of the world's fastest-growing manufacturing zones, visit the Tianjin Economic-Technological Development Area.

Ni Xiang Yu, the voluble vice chairman of the Tianjin Economic-Technological Development Area, recently delivered a pep talk to his hometown soccer team. "You have to rank first," he says he told the players for China's third largest city. "You cannot be sixth or eighth; that is not our culture."

The TEDA soccer team has yet to reach the top spot in China's fledgling professional soccer league, but Ni's tone provides a glimpse of the competitive spirit that drives TEDA to retain its status year after year as the most productive of China's special economic zones. Last year, companies in the zone produced \$55 billion (377 billion yuan) in sales, up 9.6% over 2007.

TEDA is a sprawling area that nearly surrounds Tianjin, a city of 11 million. Covering 100 square kilometers (39 square miles), the zone hosts more than 10,000 companies, including 4,600 foreign enterprises such as Motorola, Otis Elevator, John Deere, Coca-Cola, GlaxoSmithKline, Samsung, and Toyota. TEDA is a 90-minute drive from Beijing and well-served by major highways, trains, and the Port of Tianjin.

The special area reports that direct foreign investment in the first quarter of 2009 totaled \$1.4 billion, up 16.5% over the same period last year, and 25 new foreign enterprises signed contracts to set up in the zone, including Japanese dairy manufacturer Yakult. Another 35 foreign companies already in TEDA have indicated they will expand their operations, including U.S. tractor maker John Deere, which broke ground for a test center earlier this year, and Toyota Motor, which began rolling Rav4 SUVs off its assembly line. Ni says the goal for TEDA this year is to reach 25% growth. "We cannot slow down," he says. "China needs investment."

TEDA's sales pitch is centered on customer service. "We're all about: 'How we can support the customer?'" says Ni. He

points out that key Chinese ministries, including the tax authorities and foreign registration offices, operate branches at TEDA. It also helps that Tianjin is one of several Chinese cities administered directly by the central government, and that it happens to be the hometown of Chinese Premier Wen Jiabao. Ni promises foreigners help in navigating Chinese government bureaucracy. "We are the fastest," he says. "If all the documentation is ready, according to laws and regulations, we are the best [in speeding approvals]." One measure of customer



TEDA'S botanical garden is a natural retreat from the urban landscape.



satisfaction, says Ni, is repeat business. About 40% of new investment in TEDA, he says, comes from existing customers like Samsung and John Deere.

Originally set up as a manufacturing center, TEDA is determined to broaden its base. Earlier this year, Chinese leaders announced a series of measures, including lower corporate taxes and a sales tax moratorium, to promote the development of a services industry. "We welcome tertiary industries like banking and insurance," Ni assures.

As China begins to embrace green technologies, TEDA is well positioned to benefit. The zone already hosts a number of solar and wind-power manufacturers, including Danish wind turbine maker Vestas, which recently announced a \$90 million expansion of its facilities in China. "We are proud to host so many of the best businesses from all over the world," says Ni. ●