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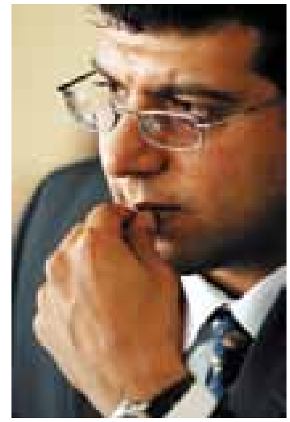

Ilan Alon, *Editor*

2008 WILL PROBABLY BE KNOWN AS the year of the Great Recession. That this great recession is the biggest turndown in the American economy since the Great Depression is already widely acknowledged. What is less known are the effects of this Great Recession and Financial Crisis, the antecedents, and the associated extent of the contagion. We have called for essays from the AIB community to contribute to this special issue. The response was strong. International business has something to contribute and something to learn from this social experiment. This issue of *AIB Insights* and the next will both feature insightful articles examining various facets of the recent financial crisis.

In the first article, Klaus Meyer examines the strategic options of the multinational firm. The analysis is insightful as it brings into consideration various aspects of management and policy decision making with implications for both short term and long term positioning. Companies that will succeed in the future are ones that will make the right decisions now and that would be able to benefit from the downturn to come up stronger in the long term when the economy revives.

Amir Shoham examines the antecedents of the global financial crisis. According to him, the current crisis has its origin in the aggregate savings rate of Americans. Since Americans have had a long term span of negative savings, budget deficit and trade deficit, structural imbalances were created. After the financial crisis precipitated, while the savings rates of households have increased, the spending rate of government increased. Therefore, structural economic imbalances persist, and the crisis may not be over. Shoham suggests that international business can contribute to the understanding of the crisis through the inclusion of cultural variables in understanding the savings rate. Preliminary analysis shows that uncertainty avoidance contributes to the savings rate.

What about the so called contagion effect? In recent years, there has been a raging debate over the (de)coupling of the global economies. With particular reference to emerging markets, China has been thought to be highly linked to the US economy. Its share of trade, investment and US debt has increased over the last couple of decades. Its capital markets are also highly volatile. But China held well during this Great Recession. Ari Van Assche and Alyson Ma investigate the impact of the crisis on China. Their insight is that China is perhaps not as vulnerable to the US economy as previously thought. Much of China's exports were only through processing exports. Thus, as exports dwindled to the US, some imports decreased, too. When taking into account the large fiscal stimulus that was also enacted, it is clearer to see why China was able to subvert some of the negative influences of the global economic recession and take the lead in stimulating global market demand.

Looking for policy solutions for the crisis, Marc Sardy recommends funding entrepreneurs. According to Sardy's brief, governments around the world have taken different paths to approaching the recovery and stimuli packages. But if these same governments are interested in fueling jobs, new industries, and innovation, they are best off offering small budding entrepreneurs access to capital. A quick analysis of how such a stimulus work in the US is provided.

Whether this crisis created a structural or simply a cyclical change remains to be seen. Consumers, businesses and governments and the relationships among them are evolving. The post crisis environment may be one of increased government intervention, more reasonable consumption, lower expected rates of return.

In the next issue of *AIB Insights*, we will feature a few more critical examinations of the Crisis. *AIB Insights* will feature articles relating to the Spanish banking system, supply chain impacts, and institutional environment.

Thinking Strategically during the Global Downturn

Klaus E. Meyer, University of Bath, United Kingdom

The global recession has likely created a structural break in the global economy. Businesses thus need to reassess their strategies for operating in a highly integrated global economy. Initial reactions have often been defensive, including downsizing and calls for government support. However, times of crisis are also times of opportunity. In the short-term, opportunities arise for instance in 'value for money' segments. However, for long term opportunities, businesses have to develop foresight to use the economic downturn to position themselves for the next upswing.

The current public debate largely focuses on the origins of the crisis,[1] yet it is time to look forward to ask, ***how can businesses survive the crisis, and position themselves for the recovery whenever it may come?*** I aim to initiate this forward-looking debate. My main focus thus is on generating ideas, rather than to provide definitive answers. I thus hope to stimulate discussions in the AIB community, and I shall share my view as the crisis evolves on my blog at www.klausmeyer.co.uk/blog (you may also find this blog useful to complement your teaching of international business during these volatile times).

> "... how can businesses survive the crisis, and position themselves for the recovery whenever it may come?"

Some Stylized Trends

The financial crisis originated from the financial sector in the USA and the UK. At the core appear to have been unsound lending practices by financial institutions, notably in the private mortgage lending sector, and unsatisfactory risk management practices (Haldane, 2009). In 2008, the contagion spread worldwide, causing an unprecedented credit squeeze as inter-bank lending came to a virtual hold. In consequence, businesses faced liquidity squeezes and consumers cut back their expenses. Worldwide GDP growth has slowed from 5.0% in 2007 to 3.7% in 2008, and in July 2009, the IMF predicted a drop (!) of 1.4% over the year 2009 (-3.8% in advanced economies and +1.5% in emerging and developing economies).[2] At the risk of oversimplification, we can summarize the crisis as follows:

1. The collapse of parts of the financial sector has created an intensive credit squeeze in autumn of 2008 that drastically reduced credit available to the real economy.
2. Asset prices have declined sharply as the burst of the housing market bubble in the USA and some other countries reduced the nominal wealth of private individuals.
3. The decline of stock markets reinforced the decline in the value of privately held assets.
4. Falling (nominal) wealth and uncertainty regarding job security depressed consumer spending, especially in the advanced economies, yet with widely varying impact across industries.
5. Exchange rates shifted considerably during 2008, including a dramatic depreciation of for instance the British pound and several East European currencies, a continuously strong Euro, and a US$ recovering from a period of relative weakness.
6. Commodity prices have declined from all time highs in 2008, providing a (probably temporary) relief of demand pressures that saw prices climb to unprecedented heights in 2008.
7. Businesses are laying off staff, resulting in rising unemployment, and anxiety among the remaining workforce. In conjunction with an emergent capitalism, critique might lead to stronger pressures from trade unions and other NGOs on economic policies.

The contagion appears to be world-wide. News commentators around the world seem to believe their own country to be less affected than most, yet this is often self-delusion. Specific effects may have a stronger effect on some countries than others, yet no-one seems to have escaped the crunch entirely.

Critical for the halting or continuation of the crisis are the ***expectations*** of consumers and decision makers in business. Any economic decision is shaped by the decision makers' expectation of future states of the world. In 2009, these expectations are characterized by a high degree of uncertainty. Key economic variables are more volatile and thus increase economic risk measures, while the awareness of the possibility of events not captured by conventional risk measures has been amplified, thus further increasing ***perceived*** uncertainty. Moreover, expectations appear to have a downward bias as a general 'sense of fear' is pervading society, nourished by dramatizing accounts in the media, which might create a self-fulfilling prophecy.

Public policy has reacted to these dramatic developments by very large fiscal stimulus policies, while monetary policy has been expansionary, lowering interest rates to historically low levels. These policy responses are fundamentally different from, for instance, the responses in 1929 when tight fiscal and monetary policy magnified the impact of the financial crisis (Galbraith, 1955; Krugman, 2008; von Mehren, 2009).

Further important policy initiatives are expected to redesign the regulation of the financial sector. In essence, such regulation must establish that those taking decisions to bear risk, such as assessing a client's credit worthiness and approving a loan, also bear the costs should the loan not be repaid. Successful redesign of the financial sector regulation and restructuring of the sector are essential to re-establish trust in banks, and to ease the credit squeeze (Johnson, 2009). A third area of public policy that might have an important impact are policies affecting international trade. Although political leaders are publicly committed to free trade, considerable concerns exist regarding the credibility of such commitments.

Business Strategies for the Crisis

How can businesses handle the imminent threats of the downturn? In the short-run, survival strategies have to address immediate threats, and may exploit temporary opportunities. In the long-run, companies have to position themselves strategically for an upswing in a 'new economy' that may be very different than the recent economic boom (Table 1).

Table 1: Opportunities of the Crisis: Key markets

Markets	Survival Strategies (short-run)	Strategic Positioning (long-run)	Challenging decisions
Finance	Retain cash flow to enhance flexibility. Sell peripheral businesses to increase financial resources.	Opportunities for those with cash reserves to acquire businesses with liquidity constraints.	Trade-offs between short-term liquidity constraints and long-term strategic investments.
Real estate and housing	Avoid high leverage to reduce risk of negative equity.	Acquire real estate at much lower prices.	Will housing prices drop further? When is the right time to buy?
Corporate assets	Avoid high leverage to reduce risk of bankruptcy.	Implement strategic change that had been inhibited by organizational inertia. Acquire assets at much lower prices.	Will share prices drop further? When is the right time to buy?
Consumer goods and services	Opportunities in niches likely to be resilient during the crisis (see Table 3).	Position in segments with long run growth potential. Develop new business models for the new economy.	Trade-offs between short- and long-term market positioning
Currencies	Flexibly shift operations to countries with devalued currencies.	Retain operational flexibility to react to future exchange rate re-alignments.	How much to base investment decisions on current exchange rates?
Natural resources	Smoothen the phase-out of energy and resource intensive technologies.	Continue to adapt to in the long-run likely higher resource costs.	How much advantages are to be gained by energy and resource saving technologies?
Labour	Downsize non-essential labour.	Retain labour that is essential for long term strategies. Train and engage staff to build a loyal workforce.	How to afford keeping people on the pay-roll when demand is low?
Public policy	a) Opportunities for sectors targeted in stimulus programmes or subsidies b) Lower interest rate create opportunities to raise capital c) Financial re-regulation should reduce costs of capital d) Protectionism may create opportunities to enter protected segments.	a) Build capabilities for long-term competitive advantages b) Invest in real assets protected from the threat of inflation c) Build solid banks using 'old-fashioned' banking principles d) Don't expect long-term prosperity in niches creates solely by protectionism.	How to predict what governments will do next?

Thinking Strategically

First priority for many businesses is to secure their cash flow, to reduce creditor risk, and to retain liquid assets. Yet, at the same time, cash-rich firms may face unexpected opportunities to acquire other businesses at depressed share prices, notably businesses facing liquidity problems. A critical decision for businesses contemplating M&As as well as individuals contemplating buying a home is the timing of their investment. Ideally, they would want to buy at the bottom of the market. However, there is no way of knowing when this bottom is reached. In fact, when a consensus suggests that the bottom has been reached, this will impact expectations and drive up prices again.

Market growth is likely to be slow in many industry segments that are affected by falling consumer spending and business purchasing, as I briefly discuss later. In the longer run, the next upswing is likely to be associated with new technologies and business models.

Exchange rate movements may in the short run trigger relocation of activities. Yet, in the long term, the US$ may not remain as strong given the US' twin deficits (trade and budget), dependence on imported raw materials and a shaky banking sector, while the Chinese Yuan in particular may appreciate due to the relative weakness of its main trading partners. Thus, exchange rates remain highly instable and difficult to forecast. Long-run strategies should thus create operational flexibility to readjust to future exchange rate movements.

Lower commodity prices benefit businesses by easing the pressures to restructure. Yet, some prices remain high, notably precious metals. Long-run strategies thus need to consider the fundamental pressures that drove up prices in the first place, such as environmental costs and the increased demand from India and China. Businesses thus have to continue to adapt to what in the long-term will likely be higher resource costs, and develop technologies to economize on these scarce resources.

With respect to labour, many businesses face challenging decisions. On the one hand, financial constraints and falling demand suggest downsizing the workforce. This may be an opportunity to streamline the organization and cut excessive slack. However, for many companies their workforce is (one of) their most valuable resource, and once dismissed, the human capital may be lost forever, which would undermine their long-term competitiveness. Hence, companies ought to think forward and retain and in fact upgrade the workforce that shall carry the company into the new economy.

Government policy intervention is creating specific opportunities for sectors favoured in fiscal stimulus programmes or protection. In many cases, increased government investment may benefit for example the construction sector, 'climate change' causes or vocational training; elsewhere subsidies may help politically influential but declining industries. Yet, if businesses in these sectors expand, they need to be aware of their dependency on government spending, which is likely to be reduced once budgets are tightened again. Recall the German recession of the mid 1990s when the construction industry suffered from its overexpansion during the government-spending driven post-unification construction boom in Eastern Germany.

Table 2: Market Opportunities During the Recession

Opportunity	Examples	Challenging Decisions
Low cost retail	Discount supermarkets for food and clothing	Is it worthwhile going downmarket, thus taking the risk of downgrading the brand?
Basic need goods	Non-branded consumer goods, foods	How can we innovate to deliver essentials at lower costs?
Help customers save costs	IT system providers, energy saving technologies	How can we convince customers that now is a good time to invest?
Help customers manage uncertainties	Risk sharing contracts	How can we assume risk on behalf of customers when credit is scarce?
Career breaks	Education, especially post-experience programmes, gap year travel, social work	How can we invest in new programmes when budgets are tight?
Entertainment	Domestic tourism, home entertainment, take-away food, sports	How can we develop budget services that fit current budget constraints but can go upmarket when the economy picks up?

> “ … the next upswing is likely to be associated with new technologies and business models ”

Market Opportunities during the Recession

Identifying markets that are likely to be resilient and potentially growing during the recession requires analyzing what people and businesses are likely to do ***more*** during the recession. This leads to several general ideas that may be applicable to a wide range of businesses (Table 2).

The most evident growth potential exists in the low price segment as many consumers shift from premium brands to budget substitutes. Consumers will always need to satisfy their basic needs, and during the recession they do so with tighter budgets. Evidence of successful value-for-money strategies exists in the low price section of the retail sector. For instance, in the UK, ASDA, Primark and the German newcomers Aldi and Lidl have been reporting substantial sales growth. Similarly, in the USA, 'dollar stores' have been reporting substantial revenue and profit growth in 2008.

Manufacturers may likewise adopt strategies of 'value for money' with low costs based on scale economies. This may involve innovations that aim not at advancing new technologies, but at modifying products, production processes and business models to deliver almost the same level of benefit to customers at much lower costs. However, many of the companies serving this segment are either sourcing from emerging economies, or originating from emerging economies. In fact, emerging economies like China, India and Brazil have recently seen fast growth of mass consumer markets with comparatively standardized products at low prices. Local businesses and some MNEs, such as Unilever, have developed business models specifically for this segment. Willamson and Zeng (2009) thus recommend that businesses in Europe or North America partner with businesses in emerging economies, but not, as was traditionally the case, to target emerging economy markets, but to join forces in targeting the budget segment in mature market economies.

Business-to-business markets are likewise affected by tighter budget constraints, as the credit crunch induces cuts in non-essential purchases. This has grave consequences for service providers such as external consultants. If, for example, IT budgets are cut by 25%, while 70% of the budget is spent on maintenance, then only 5% of the budget is available for new acquisitions of hardware or software. Thus, IT service providers have to offer services that help their customers to save IT maintenance costs, or costs elsewhere in the organization. Unsurprisingly, Microsoft reported record losses in summer of 2009. However, the cost-saving motive has enabled some service providers to report brisk business as more firms accelerate outsourcing.

An additional obstacle to major purchases is often the risk that adverse events during the life time of the item may affect its value, or the buyer's ability to pay for it. For example, people worried about losing their job are likely to postpone buying a new car, especially if they need to finance it with a bank loan. If sellers can help manage this risk, this may ease purchasing decisions. For example, Hyundai USA generated considerable attention —and sales— by offering to buy back cars if customers lost their job within a year of the purchase. Effectively, Hyundai offered an insurance policy along with the purchase of a car. While this needs to be factored into the purchase price, this approach helps customers managing the investment risk. More generally, the principle of sharing risk with customers may provide opportunities for business, though it needs to be balanced with the credit risk thus assumed on behalf of the customer.

An industry that tends to be fairly resilient to economic downturns is entertainment. People may spend less on long distance travel and expensive days out, a tendency that is likely to be reinforced by the flu epidemic. Yet they substitute such activities by domestic travel and stay-at-home entertainment. This creates opportunities for local and regional tourism destinations, as well as all businesses that provide for an enjoyable day at home. A wide range of industries may try to tap into this opportunity, including sports, video games, children's toys, take-away and ready-to-eat meals (substituting for days eating out).

Many people wish to use their involuntary career break (less fashionably known as unemployment) in a useful way. Thus, reportedly, exotic locations around the world see large numbers of city traders enjoying a modern form of gap year. Business opportunities thus arise for those who can facilitate such travels as travel agents or tour operators. Others may wish to invest in their own future and enroll for further education, such as MBA. Those offering higher education thus face considerable opportunities to upgrade and upscale their programmes. However, they would have to react flexibly and un-bureaucratically to design and implement new programmes, which creates formidable opportunities for non-traditional institutions.

Long term restructuring: In search of the new economy

The global crisis represents a 'structural break', that is, a moment in time when the basic trends and patterns of the business environment are likely to change in many industries. This creates both challenges and opportunities for businesses to create new strategies and business models based on a comprehensive reassessment of all strategic parameters (Rumelt, 2009). The successful design of a new strategy however requires a vision of what the new economy may look like, and where the business ought to be positioned within this new economy. Businesses may thus employ scenario techniques to develop an understanding of possible future states of the world (Shoemaker, 1995).

Which industries are worthwhile to be in? This question is hardest to predict of all, and whoever get its right is likely to earn handsome returns. Based on mostly informal brainstorming in various groups of students and executives, I suggest the following growth of the new, post-recession economy:

- *Green energy*, which includes for instance energy saving technologies in businesses and home as well as alternative energy generation technologies such as wind energy, solar panels and tidal wave power plants.
- *Heath and social care*, which includes services as diverse as hospitals, beauty treatment, child care, and care for the elderly as well as equipment manufacturers supporting these services, including new technologies such as biotechnology.
- *Nutrition and foods* helping a healthy lifestyle, for instance organic foods and new forms of delivering fresh foods to households and restaurants.
- *Entertainment* in a broad sense including for instance movies and theme parks as well as various forms of home entertainment such as video games, and entertainment delivered via the Internet.
- *Education* in a broad sense, including pre-school, primary, vocational, and higher education, as well as training in specialized professional skills and foreign languages.
- *Cost-efficient provision of basic needs*, especially to the 'base of the pyramid' but – at least during the crisis – also in some mature market economies.
- *Consultancy*, especially those helping businesses with new financial regulation, with organizational change, and with cost oriented process re-engineering.

A common theme in many of these industries is the confluence of manufacturing and services. Traditionally, manufacturing and services were quite distinct, yet in the last decade many manufacturing companies found themselves earning more money from associated services and replacement parts. This shift is driven by innovations of business models, which may have become more important in driving change than technological change alone. Experimentation with new business models may thus be an important way to advance ahead of competitors into the new economy.

Conclusion

The financial crisis of 2008 had a disruptive effect on many industries, and it is likely that we are experiencing a structural break with the emergence of a new economy that is driven by new business models and industries. In this crisis, businesses need two kinds of strategy, a survival strategy and a strategy of positioning for the new economy. The survival strategy may focus on segments likely to be resilient during the downturn, and it needs to be very cost and cash conscious. The strategic positioning needs creative thinking and experimentation with new business models, and the ability to recognize what forms of restructuring may be implemented during the crisis. If business leaders manage to adapt a forward looking approach, they should be able to lead out of the downturn before long.

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Endnotes

1 The contemporary discussion and analysis of the origins and spread of the crisis can be followed in *The Economist*, see for instance: "Finance and Economics: Mortgage Lending (16 December 2006), "Briefing: Securisation" (22 September 2007), "Briefing: Northern Rock" (20 October 2007), "Economic Focus: Same as it ever was" (12 January 2008), "Economic Focus: Chain of Fools" (9 February 2008), "Briefing: Wall Street's crisis" (22 March 2008), "Briefing: A short history of modern finance" (18 October 2008).

2 International Monetary Fund (2009): *World Economic Outlook Update: Contractionary Forces Receding But Weak Recovery Ahead* (July 9, 2009), www.imf.org/external/pubs/ft/weo/2009/update/02/.

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The Savings Crisis and International Business

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When considering the current economic crisis we can discern that variables of two different types contributed to its creation and magnitude. The first are the real variables that caused the initial imbalance in the economy. The second variables are the nominal ones, which are usually catalysts that accelerate situations. Metaphorically, the real variables can be compared to fire and the nominal ones to the fuel. Considering the way the crisis evolved, there is a clear view of the chief real variable that caused the crisis. This variable is the change in the savings rates, primarily in the US. International business research has a few powerful tools that should help explain the national differences in savings and fill the gap in the current academic literature and research. The literature on business culture might help explain the variations in saving rates in different countries. Hofstede's (1980, 1983) scores or the values defined in the GLOBE study (House et al., 2004) would be an excellent place to start. Additional future research on the topic could use different clusters of nations, as in Ronen and Shenkar (1985) or Gupta (2002), to explain different patterns of personal and national savings in different groups of countries.

If we briefly review the history of the crisis, we see that the first signals of genuine economic instability began to appear in the first half of 2007, when a large wave of sub-prime mortgage lenders in the United States became insolvent. However, the seeds of the crisis were planted many years before. The United States created a deficit in its current account that grew steadily throughout the last decade. The deficit on one side of the ocean created surplus on the other side, especially in countries like China and Singapore. These countries then loaned the surplus back to the US so that it would be able to continue buying imports. Usually, a current account deficit is highly correlated with a government deficit, and the data from years before the crisis show that the US is no different (see Table 1).

During this period, several bubbles were created in the American economy. The first bubble appeared in the lending market, led by the housing market where mortgages are granted to sub-prime borrowers and prime borrowers with low self-equity. These loans expanded beyond all reasonable proportions because of the financial system's eagerness for short-term profits. This eagerness was ignited by short-term incentive contracts signed with managers of financial companies or what is known professionally as the "principal-agent problem." Simultaneously, mortgages became securitized, which created an additional problem when rating companies granted these securities AAA ratings despite the high risk levels. The lack of supervision over the highly-influential rating companies working in an unregulated branch exacerbated the crisis.

From a brief review of the crisis we can identify the three real variables (all the other variables are nominal) that were unbalanced for a long period:

1. The US current account deficit.
2. The US government deficit.
3. Private consumption in the US.

The master variable that made a major contribution to the creation of all three real variables is the change in the savings rates in the US. A nation's savings is the aggregate of the savings of the business sector (SB), personal savings (SP), and government savings (SG). The US government (primarily on the federal level) made a rather large change in its fiscal policy. During the last years of the Clinton administration, the federal government had a budgetary surplus. The highest surplus was 1.62% of GDP, in 2000. By 2003, this surplus had been replaced with a deficit of 4.83%, as can be seen in Table 1. The federal expenditure was about 20% of the GDP in 2003. That means

Table 1: US Balances[1]

	2001	2002	2003	2004	2005	2006
Federal balance percent of GDP	-0.389	-3.789	-4.833	-4.353	-3.258	-2.239
Current account balance percent of GDP	-3.798	-4.406	-4.775	-5.348	-5.869	-5.98

Source: International Monetary Fund, World Economic Outlook Database, April 2009

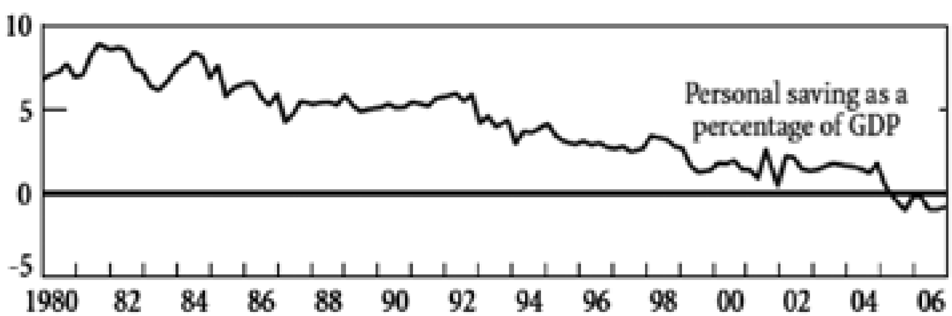
> “… *the most interesting change in U.S. savings was in the sharp and steady decline in the personal savings* ”

a reduction of

$$32.2\% = \frac{1.62\% - (-4.83\%)}{20\%}$$

in SG. This means there was a sharp decrease in public savings over a short period. Several factors contributed to the deficit, including the Bush administration's dual policy of simultaneous fiscal expansion and tax reduction. However, the most interesting change in US savings was is the sharp and steady decline in the personal savings, that started in 1984, as can be seen in Figure 1.

Figure 1: U.S. Personal saving as a Percentage of the GDP



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

The decline is particularly striking because the saving rate remained relatively stable, at an average of 7% to 10%, from the end of World War II through 1984. It is clear how low government and private saving in the US created the government's deficit and stimulated private consumption, respectively. Furthermore, these are also the main factors in the US current account deficit. This can be explained by the macroeconomic identity that is taught to beginning students of economics:

$$S^G + S^B + S^C = I + (EX - IM)$$

When I = local investment, EX = export, IM = import.

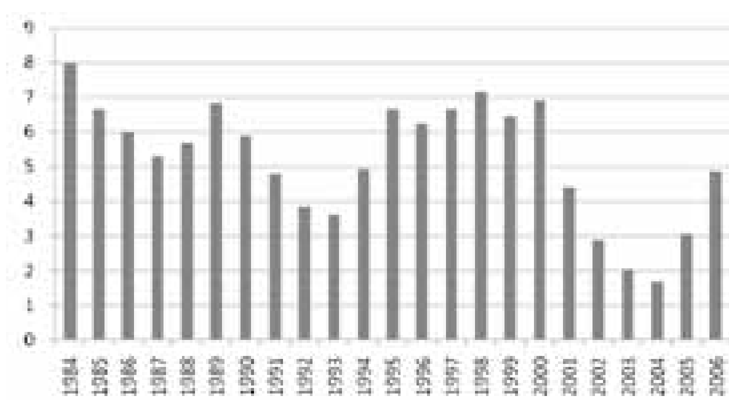
The sharp decline in the federal savings during the last decade plus the ongoing decline in personal savings from 1984 until 2006 caused the deficit in the US current account, as can be seen from the above identity.

The phenomena of the diminishing personal savings cannot be explained simply by the current economic literature and variables like interest rates, age of population, and wealth as expressed by GDP per capita. For example, Figure 2 displays the real interest rates in the United States in the last two decades. It shows that that there were no major changes in the real interest rate from 1984 to 2000, but there was a major reduction in the rate of savings. By contrast, if we compare an average Chinese citizen and an average American citizen with the same objective variables (interest rate, age, etc.), it is most likely that the Chinese citizen's marginal propensity to save part of his free income will be much higher than the American's.

The different saving patterns also led to the diverse ways that governments intervened to solve the crisis. For example, the US used tax cuts to stimulate the real markets due to its high marginal propensity to consume and low marginal propensity to save, while China, which has high saving rates, used a huge stimulant package focused on investment.

Preliminary results of my study on the topic support my claim that culture can help in explaining the difference betweens saving rates in various countries. The dependent variable in the study is the Gross Domestic Savings rate (% of GDP) for 56[2] countries for the year 2007, taken from the World Bank Indictors (WBI) database. The independent variables included Uncertainty Avoidance (UA) as the culture variable that should have the most impact on saving. The scores for UA were taken from the GLOBE scores. I used a few control variables, which can be seen in Table 2, based on the economic literature about saving.

Figure 2: U.S. Annual Real Interest Rate



Source: World Bank, WDI data.

> *... there is strong support for the hypothesis that culture has impact on savings*

The regression used to investigate the data was an OLS regression, because I conducted a Kolmogorov-Smirnov goodness-of-fit test on the dependent variable. The results showed that the variable was normally distributed, so I assumed that the errors distribute normally. Since culture (UA) is exogenous and I did not have a time series to overcome any potential bias for the saving rates of 2007, I conducted a Person correlation test between the average saving in the last 10 years and 2007. The correlation was high and significant. Table 2 presents the regression results.

Table 2: OLS regressions dependent variable Gross Domestic Saving (% of GDP)

-10.93	Constant
1.727**	GDP Growth (%)
0.008*	GDP per Capita
-0.06	Interest Rate Spread
-0.248+	Real Interest rate
6.743**	UA

F=7.795 (P-Value=0.000) Adjusted R Square = 0.453

**P-Value<0.01 * P-Value<0.05 +P-Value<0.1

As can be seen from the regression, there is strong support for the hypothesis that culture has impact on savings. The regression shows that high levels of uncertainty avoidance in a country's culture will lead to higher saving rates in that country. This outcome provides preliminary support for the relationship between culture and savings. Deeper and wider research should be conducted to provide further support. As noted in the introduction, academic international business research can make an important contribution to the current literature on the topic and to policy-makers understanding thereof.

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Footnotes

1 The data presented in the paper is prior to the crisis (until 2006), because the paper concerns the factors that created the crisis.

2 I used countries that had only one score for UA in the GLOBE study.

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China's Trade in Crisis

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In December 2008, China celebrated the thirtieth anniversary of reforming and opening up its economy. For international business scholars, this historic event is one of the key milestones of the past half century. In 1978, China took its first cautious steps to set up an export-led growth model by establishing four Special Economic Zones where foreign direct investment received preferential treatment and regulations were streamlined for export promotion. From then on, its economy has witnessed a stunning and highly praised trade expansion that has become one of the most important drivers of the global trading system. Since 1988, China's exports have expanded at an annualized rate of 19 percent, more than twice the growth rate of world exports. Recently, China has surpassed the United States to become the world's second largest exporter behind Germany.

The current economic crisis, however, has dampened the sentiment for celebration. With US, Japanese and European markets in recession, the demand for China's exports has experienced a stunning contraction. In the first quarter of 2009, exports were down 20.1% compared to the previous year, from US$304 billion to US$243 billion. Many observers consider this exports downturn especially worrisome since they believe that China's export-led growth model has rendered its economy excessively dependent on the business cycles of advanced economies. Two trends in China's exports have spurred this apprehension. First, the composition of China's exports has rapidly shifted towards high ticket-item durables such as electronics that are more sensitive to foreign business cycles. Second, China's export dependence seems to have risen rapidly over the reform period, with its exports amounting to 42% of its gross domestic product (GDP) in 2007.

Perhaps surprisingly, the most recent economic indicators suggest that, despite the sharp decline in exports, China's economy is likely to escape the crisis relatively unscathed. In the first and second quarter of 2009, China's GDP has expanded at an annualized rate of 6.1% and 7.9%, respectively. This remarkable resilience of China's economy is generally attributed to its government's massive economic stimulus package and its banking sector's aggressive credit expansion. However, we would like to argue that another key reason is that China's economy is much less dependent on its exports than it is traditionally thought, so that sharp export declines should not have a big effect on China's overall economic performance. Central to our claim is that the empirical data commonly used to analyze China's export dependence are often misinterpreted.

Arguments in favor of China's increasing export dependence

In the past fifteen years, the composition of China's exports has shifted towards high ticket-item durables such as electronics. As it is shown in the left panel of Table 1, between 1992 and 2006, China's electronics exports grew at an annualized rate of 30.3% per year, which is almost double the growth rate of its other manufacturing exports, and almost quadruple the rate of its non-manufacturing exports.[1] As a consequence, electronics exports have grown to more than one third of China's total export value.

Table 1: China's exports statistics, by sector

	Exports (US$ millions)		Annualized growth rate (%)	Exports share (%)		Exports growth (%)
	1992	2006	1992-2006	1992	2006	08Q1/09Q1*
Electronics	8,360	341,000	30.3	9.8	35.2	-24.8
Other manufacturing	72,000	615,000	16.6	84.8	63.4	-17.9
Non-manufacturing	4,600	13,200	7.8	5.4	1.4	3.08
Total	84,960	969,200	19.0	100.0	100.0	-20.1

*08Q1 = First quarter of 2008. 09Q1 = First quarter of 2009.

Source: Authors' calculations using China's Customs Statistics

This increasing specialization in electronics exports has led to the concern that China's exports have become more sensitive to downturns in foreign business cycles. The reason is that, in times of recession, households and companies in advanced economies tend to hold off first and foremost their purchases of durable goods, and especially larger ticket-item goods including electronics products.

> *China's economy is much less dependent on its exports than it is traditionally thought.*

This not only reflects the fact that tightening budget constraints in times of crisis render high ticket-item goods unaffordable for some, but also that consumers and firms in such uncertain times want to wait with their purchases of long-lasting goods until it is known with more certainty whether and when the economic climate will improve. A recent study by Engel and Wang (2008) indeed finds that US durable goods imports are more sensitive to business cycles than nondurable goods imports. Furthermore, Aziz and Li (2008) demonstrate that China's increasing specialization in electronics exports has led to an overall rise in the income elasticity of China's exports.

Recent trade data corroborate this concern: the recent downturn of China's exports has predominantly been driven by a contraction of electronics exports. As it is shown in the right panel of Table 1, in the first quarter of 2009, China's electronics exports were down 24.8% compared to the same quarter of the previous year, which is larger than the 20.1% drop of China's total exports.

The higher sensitivity of China's exports to foreign business cycles is considered especially problematic since China's economy appears to have become more dependent on its exports over the reform period. A commonly used measure for a country's export dependence is its export-to-GDP ratio. According to this ratio, China's export dependence has risen rapidly from 15% in 1988 to 42% in 2007. This figure is much higher than for other large economies such as the United States, European Union and Japan which in 2007 had export-to-GDP ratios of 12%, 12% and 18% respectively. This second trend has further fueled the fear that China's export-led growth model has rendered its economy increasingly dependent on the business cycles of advanced economies.

Issues related to the measurement of China's export dependence

Is the Chinese economy's dependence on foreign business cycles real or a statistical mirage? The key issue to bear in mind here is that China's exports do not necessarily depict the value that is produced by its export sector, but rather represent the gross value of the goods that leave its borders. To see how this may create biased perceptions, consider the example of the iPod, which Apple Inc. assembles in China and exports to the rest of the world. In 2006, the export value for a 30GB video model that left China's borders was about US$150. However, Linden et al. (2007) estimate that only US$4 (or 2.6% of the export value) was produced in China, with the large brunt of the export value being produced in and imported into China from the United States, Japan, and Korea.

The difference between China's export value and the share of this value made in China is relevant for understanding its economy's vulnerability to the global economic crisis since, as the iPod example illustrates, China heavily relies on imported inputs for its exports. This hefty dependence on imported inputs is largely driven by China's creation of a processing trade regime in the mid-eighties. Under this export-promotion program, firms are granted duty exemptions on imported inputs as long as they are used solely for export purposes. Many primarily East Asian firms have taken advantage of this regime to slice up their value chains and move their labor-intensive final-assembly plants to China. As a result, the share of processing exports (i.e., exports conducted under the processing regime) in China's total exports has risen from 30 percent in 1988 to 53 percent in 2006. Currently, China thus has a dualistic export regime with about half of its exports consisting of processing exports, and the other half of ordinary exports.

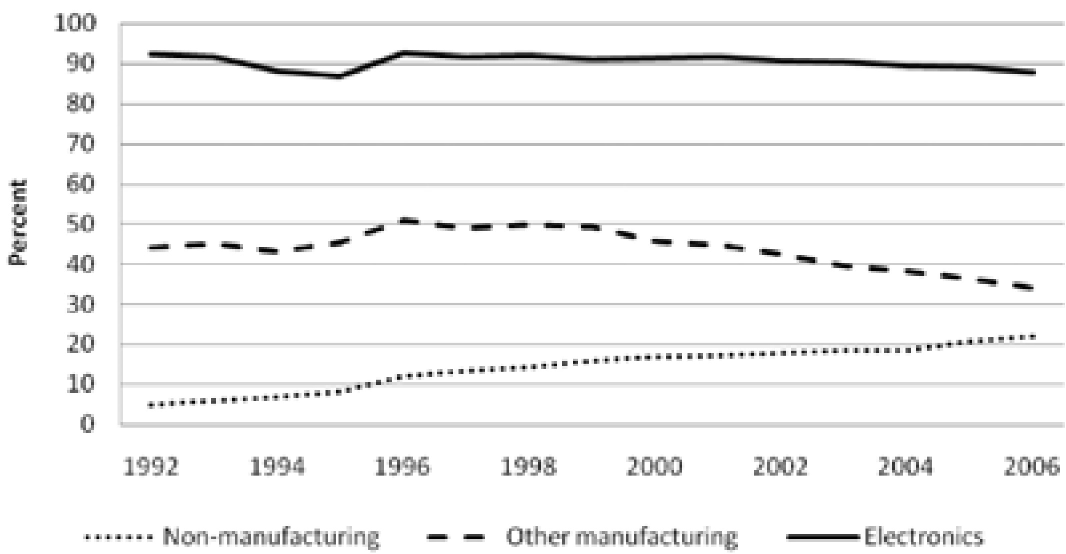
A key difference between the two types of exports is that processing exports rely much more heavily on imported inputs than do ordinary exports. According to a recent study by Koopman, Wang and Wei (2008), only 18.1% of processing exports are made in China, with the remaining 81.9% corresponding to the value of imported inputs. Conversely, a much larger 88.7% of China's ordinary export is produced in China.

This dualistic feature of China's exports has important implications for understanding China's export dependence. First, since processing exports account for more than half of China's total export value, the share of China's exports that is made in China is much lower than for most other countries, amounting to only 50.8% in 2006 (Koopman, Wang, & Wei, 2008). In other words, approximately half of China's total export value is the value of the imported inputs that are embodied in the export products. This implies that China's export dependence is more limited than its export-to-GDP ratio would suggest. Indeed, if only the share of exports that is made in China is considered, then China's export-to-GDP ratio drops to 21%, which is only slightly higher than that of Japan.

Second, it also allows us to reconsider the claim that China's increasing specialization in the more volatile electronics exports has rendered its economy more vulnerable to foreign business cycles. This is not necessarily the case since electronics exports are almost entirely conducted under the processing trade regime. As it is shown in Figure 1, almost 90% of China's electronics exports are processing exports, whereas this portion is much lower for other manufacturing exports (30-50%) and non-manufacturing exports (5-20%). As a result, a significantly smaller portion of the value of electronics exports is made in China than for other sectors. So even if the increasing specialization in electronics exports has made China's exports more volatile, it is not necessarily the case that its export production activities have become more vulnerable to foreign business cycles.

In sum, these considerations imply that, due to the large role of processing exports, China's economy is much less export dependent than it is thought traditionally. As a result, the sharp export decline in the realm of the current economic crisis should not necessarily have a big negative effect on its overall economic performance.

Figure 1: Processing exports as a share of total exports (percent), by sector, 1992-2006



Source: Authors' calculations using China's Customs Statistics Data.

> *"Is the Chinese economy's dependence on foreign business cycles real or a statistical mirage?"*

Processing trade and business cycle pass-through

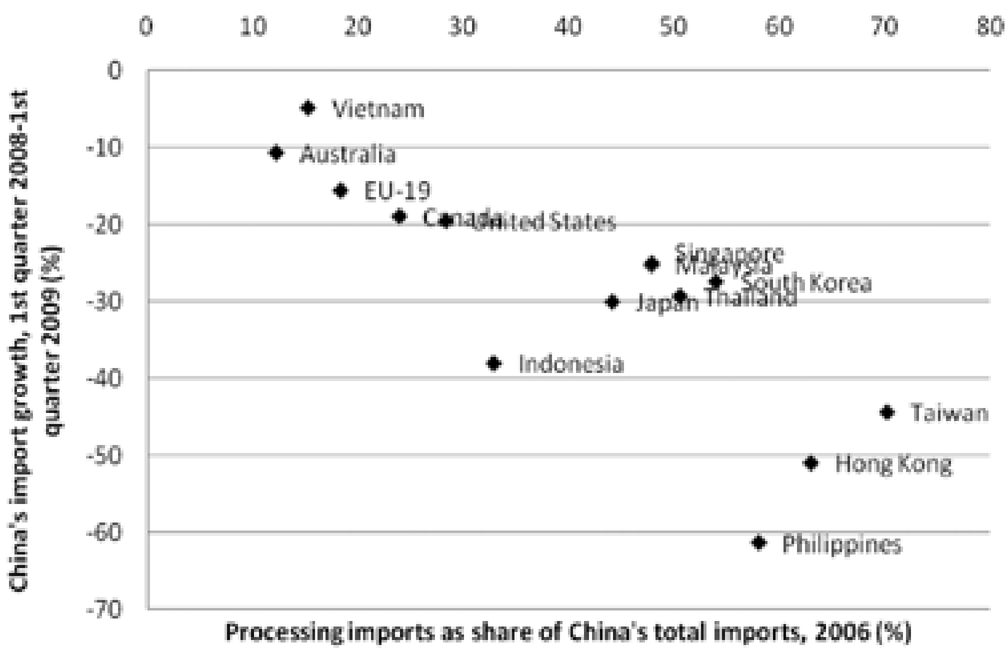
If the sharp decline in China's exports does not have a big impact on its own economy, then who bears the economic burden of the drop in exports? In Ma and Van Assche (2009), we show that China transfers a large portion of its negative export demand shocks to the countries that intensively supply China with its processing inputs by reducing its demand for their processing imports. Two recent indicators corroborate this business cycle pass-through effect. First, despite relatively robust economic growth, China's imports have dropped 31.1% in the first quarter of 2009. Commodity price declines played a large role in the contraction of imports (Petri & Plummer, 2009), but electronics imports also dropped a sizeable 30.5%.

Second, the recent economic crisis is hitting most severely China's imports from countries that more intensively supply China with its processing inputs, that is, its East Asian neighbors. As it is shown in Figure 2, with the exception of Vietnam and Indonesia, more than 40% of China's imports from its major East Asian trading partners were processing imports in 2006, which is a significantly higher share than for countries outside of East Asia. These East Asian countries have witnessed the largest import decline in the realm of the current economic crisis. Compared to the previous year, China's imports from its major East Asian trading partners have all declined between 25% and 61% in the first quarter of 2009. In contrast, China's imports from its major non-Asian trading partners have dropped less than 20%.

Conclusion

China's rapid emergence as an export powerhouse has largely been driven by multinational firms that have offshored a slice of their value chain—labor-intensive final assembly—to China for export purposes. It is often neglected, however, that these firms' assembly plants heavily rely on imported inputs, while only a relatively small portion

Figure 2: Intensity of processing imports (2006) versus severity of imports contraction (08Q1-09Q1), by country.



Source: Authors' calculations using China's Customs Statistics.

of the export value is produced in China. In the media and even in academic work, this often leads to misinterpretations of China's role in the world economy.

The misconception that we attempted to demystify here is that China's economy has become excessively export dependent, and thus particularly vulnerable to the current economic crisis. We showed that, due to China's heavy reliance on imported inputs from within the East Asian region, China's economy is actually less export-dependent than it is traditionally thought. By doing so, we also provided evidence that China effectively transfers a large portion of its negative export demand shocks to its East Asian neighbors by reducing its demand for their processing imports. During the current economic crisis, this business-cycle pass-through effect implies that the large brunt of the burden of China's export decline falls upon its East Asian neighbors.

These findings complement our earlier work, which has focused on two other misconceptions about China's role in the world economy. First, in many advanced economies, a key public concern related to China's economic rise is that its export mix is upgrading rapidly to high-technology products such as electronic and telecommunications equipment. This has created the fear that China is rapidly moving up the technology ladder and becoming competitive in technology-intensive areas where advanced economies should have a comparative advantage. Van Assche (2009) and Van Assche and Gangnes (2009), however, show that this is largely due to a misinterpretation of exports statistics, and that China's production activities are generally not more sophisticated than one would expect from its level of development. Second, China's dramatic export rise is generally attributed to features of its domestic environment: its relatively low labor costs and its aggressive export promotion policies. Ma, Van Assche and Hong (2009), however, find that another driving force behind the success of China's trade expansion is its geographic location within the East Asian region. They show that multinational firms generally use China as an export-processing platform (i) because it is located close to East Asian input suppliers and (ii) because it is in the vicinity of large East Asian markets. This suggests that the success of China's export-led growth model is crucially linked to the economic development of the East Asian region as a whole. Overall, this line of research thus highlights the importance of better understanding the configuration of global production networks for analyzing China's role in the world economy.

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Endnotes

1 Following Reed Electronics Research (2007), electronics include the following categories: electronics data processing, office equipment, radar communications & radar, telecommunications, video equipment, audio equipment, active components, passive components and other components.

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An Entrepreneurial Approach to Global Stimulus

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Never before has so much been given by so few to so few at the expense of so many. 2008 saw record deficits worldwide as countries made efforts to fix the global economy by shoring up their banking systems. Most governments made this decision as a series of follow the leader actions advised by the very institutions that created the problem in the first place. The end result was trillions heading into the coffers of morally hazardous institutions to shore up their losses, balance their financial statements and provide cheap capital to acquire those banks too weak to save themselves from consistently bad decisions that were the hallmark of the last eight years of cheap government money.

Undoubtedly during the next year significantly more public funds will be used to rescue the global economy, while monetary policy will send trillions hurtling towards markets everywhere. Yet, despite the spin on the necessity of liquidity and how the banks will disperse their funds, how might the global economy actually be better served? One answer might be found in the funding of entrepreneurship and in the creation of a better system for facilitating their growth and advancement. In Table 1, we see that many of the stimulus plans are primarily aimed at fiscal policies that will do for nations and states what the banking stimulus did for their banks: shore up balance sheets with little long term effect on the economy.

Table 1

Stimulus Plans by Country

Country	infrastructure	social welfare projects	value added tax cuts	tax rebates to consumers	rural basic construction	education and health care	environmental protection	Financial institutions	SME	Industry	Government spending	Percent of GDP	Total
China	X	X	X		X	X	X					16.23%	586.00
Japan			X					X				11.70%	316.30
Brazil	X		X									14.00%	283.30
Argentina										X		0.64%	3.80
Chile	X		X	X							X	1.30%	4.00
Mexico	X		X								X	0.37%	5.80
South Africa	X		X									24.00%	3.60
Israel			X								X	2.60%	3.06
Italy	X			X								0.09%	2.00
France	X									X		1.30%	33.00
Sweden	X					X						0.23%	1.00
Finland	X			X								0.80%	2.00
Portugal	X					X			X			0.90%	2.00
Germany	X			X		X			X	X		2.60%	96.00
Britain			X						X			1.10%	30.00
EU-wide		X		X								1.30%	254.60
Hungary								X				11.00%	13.70
India	X		X	X					X			0.80%	8.00
Indonesia	X		X							X		1.50%	6.30
Thailand				X		X					X	1.30%	3.30
Vietnam				X		X						8.50%	6.00
Singapore				X				X		X		8.40%	13.60
Egypt	X									X		4.20%	5.40
Russia										X			5.00
United States	X	X		X		X	X					5.69%	787.00
Norway	X									X	X	0.46%	2.20
Poland							X	X		X		3.50%	31.40
Canada	X		X	X								1.90%	30.00

Source: [illegible]

> *What kind of stimulus would have the largest impact to help revive a failing economy?*

Many of the stimulus plans are focused on infrastructure, tax cuts or large industries. Very few countries (the UK, India, Portugal and Germany) are putting an emphasis on helping SMEs (small and medium enterprises), none are emphasizing microfinance, and in all of these cases the stimulus is more of a token gesture than a serious effort. While this is consistent with some policies of the New Deal era that addressed problems of the Great Depression, the world is a markedly different place than it was in the 1930's. In the developed world there are far fewer unemployed blue-collar "infrastructure" workers than there were in the 1930's. In the earlier era, many of those infrastructure workers came from failing farms or factory work. Today's unemployed white-collar workers have far less interest in blue-collar work. Tax cuts are only useful for people who are working, and they do not have as much impact on putting people back to work as they are generally larger for wealthier individuals who have a higher propensity to save than the lower income categories. Below, Table 2 is an example of various stimuli and the effects on GDP for the US through the multiplier effect.[1]

Table 2

Policy	Multiplier Effect on GDP
Film industry Tax Rebates*	2.00-3.50
Unemployment benefits	1.73
Tax Rebate to Lowest Tax Bracket	1.34
State Government Aid	1.24
Child Tax Credit Rebate	1.04
Marriage Tax Penalty	0.74
Alternative to Minimum Tax Adjustment	0.67
Marginal Tax Adjustments For individuals	0.59
Dividend Capital Gain Adjustment	0.09
Estate Tax Reduction	0.00

Source: Krugman & Wells (2009), Wodward, Guimaraes, Canfield, & Dupree (2008), Oxford Economics (2007)

These historical results (which are by no means comprehensive) show there is more "bang for the government buck" when it is given out as emergency aid or unemployment benefits (multiplier of 1.73) than for a reduction in the marginal tax rates (multiplier of .09) or a reduction in capital gains taxes (multiplier of 0). There is more "bang for the buck" when tax rebates are given to film companies (which are a lot like entrepreneurial startups) than many other forms of government incentives. All of this both raises and underlines my original question: What kind of stimulus would have the largest impact to help revive a failing economy?

We must look for answers that consider these four criteria:

- Does the stimulus create new jobs (not just maintain existing ones)?
- Does the stimulus create the potential for new industries?
- Does the stimulus provide a vehicle to drive existing businesses to a more competitive position?

And most importantly:

- Does the stimulus fuel a virtuous cycle of stimulating consumption and production?

For a moment, let us consider the 700 billion dollars recently spent to bail out the banking system in the US. Much of that money never saw loans to small, medium or large business nor did it see loans to consumers or entrepreneurs. At best jobs were sustained; very few were created. Much of the money exchanged hands among investors as the government became one of the largest shareholders of pseudo-preferred shares. Large banks were merged or acquired, but there was very little impact on the economy.

However, if a large portion of these funds had been dispersed among entrepreneurs through a micro/small/medium business type loan system or self-policing regulated loan system where firms would have been able to borrow up to one million dollars (or more for larger firms), each billion dollars would have funded as many as 1,000 businesses. A graded system of loans scaled to the size of a firm would have been able to support hundreds of firms for each billion dollars, providing small firms with a needed infusion of capital. The effect would have been to create a wave of new businesses, to shore up older firms and to give new life for firms floundering in the midst of their potential growth.

> ... *Perhaps what is needed to turn the global economy around is a reverse: putting more of the stimulus in the hands of more entrepreneurs*

Now let us consider the number of jobs this kind of loan system would have created or sustained. If we assume firms were able to use 80% of the funds towards salaries, and salaries were 34 thousand dollars a year (US national average): 23 jobs per million dollars loaned. Admittedly a paltry number, but if you consider the upper boundary of 700,000 companies creating or sustaining these jobs, the effect would be to add (for a year at least) as many as 16 million jobs to the economy; even if it was half as efficient there could still be an upper boundary of 8 million jobs.

Of course no country would put its entire stimulus package in just one place; this approach would meet our first criterion, job creation. Assuming that the income multiplier effect worked well and this money ended up in the hands of people who would spend most of it, a marginal propensity to consume of .9 (or a multiplier of 10) means that each dollar would be spent roughly ten times giving the 700 billion a potential impact of 5.6 trillion[2]. If we consider the lower multiplier associated with businesses on investment and its return, the value is more like 2.5, giving the 700 billion an impact of 1.75 trillion dollars. When you consider the income multiplier is higher as the income is lower, the economy of virtually any nation would jumpstart rapidly as so many of these jobs were created.

Now let's consider the effect of creating new business or stimulating old ones. Existing businesses given a new opportunity to expand may become more aggressive. This would revitalize some industries that had stagnated as a result of the shortage of lendable funds. Their precarious position in the weak global economy would make them considerably more careful about their choices. That care should make them more effective as they moved forward.

On the other hand consider the effect of adding thousands of new small businesses to the economy and the strength that would come from new ideas and creative approaches taken by these new entrepreneurs; even if many failed, many would survive. The survivors would each add to the new economy in a positive way. These new firms might help through employment of the unemployed, and through the sheer power of unleashing the dormant creativity and entrepreneurial energy across the economy. New industries would be spawned and perhaps one of them (or maybe several if we are lucky and strategic) would become the major industry of the next decade.

Consider the effect on job creation. In most countries the sheer number of unemployed has been climbing month after month. By opening the opportunity for loans to small entrepreneurs at low interest rates many of these people could be put back to work. This would create opportunities for people in many different fields.

Further studies show that entrepreneurship is facing significant economic challenges as small firms are much more sensitive to large changes in the economy.[3] Smaller firms will have a harder time finding markets for their products or services. Yet, there has historically been great value to a country for supporting nascent businesses. Sadly few developing economies have seen this opportunity and are putting more support into entrepreneurship; at present only China and India are doing so. However, very little (as a percent of the total stimulus) is targeting SMEs for support.

Current markets are still extremely dependent on the price of oil. Consider that the current crisis had a tipping point when the contract price of oil hit $140 a barrel. In figure 1 the price of oil is shown in comparison to the international shipping volume, measured on the Baltic exchange.

Figure 1

From figure 1 it is clear that the international shipping volume fell off drastically as the price of oil peaked in 2008. The volume decline flattened out as the oil contract prices fell below $50/ barrel. Incidentally prices have risen since first quarter 2009 and the shipping volume has been extremely volatile. While this has been a trigger for economic collapse, it has been a source of inspiration for development of new green and alternative industries. It has also been a global wake up call for governments to create policies aimed at stimulating entrepreneurship in the energy sector.

Unfortunately, there is still a lot of money heading towards a relatively small group of beneficiaries. This small group of recipients does very little to move the global economy back to growth. The evidence showed in Table 1 suggests there are very few countries that see entrepreneurs as a worthy destination of stimulus funds. Perhaps what is needed to turn the global economy around is a reverse: putting more of the stimulus in the hands of more entrepreneurs, entrepreneurs who are more likely to create jobs, develop new industries, and put the global economy back on track, and entrepreneurs who can start micro businesses at a grassroots level and build them into thriving industries.

The suggested loan programs have several advantages over the current approaches being taken worldwide. Consider that small businesses have been shown to be the best creator of jobs. These loans offer similar advantages to micro-loans in the underdeveloped world, differing in size but with the same human resource benefits. These loan programs might unfreeze the business loans now frozen by many large banks. Although it is not clear that financial institutions in their current form would be the best administrators of these types of loans, something more like microfinance institutions might do a better job. Yet we might also consider that since these are modest sized loans there is not a big difference between high end mortgages and such loans. Banks already have the infrastructure in place. Hence, they offer a quick method to get stimulus loans enacted.

Ultimately, because the loans are to business enterprises, we can expect innovation and technological benefits. This approach would offer large multiplier effects on consumption. Banks would be induced to return to the smaller business loan programs. The loan structure can model regulations that work for small entrepreneurs. For the most part, they would offer an employment strategy for a relatively small price.

While it is true that administration of such loan programs could be a nightmare, there are already government institutions in place, such as the Small Business Loan Program (SBLP), that have been doing these kinds of loans for some time and have been both effective and widely respected. However, the devil is in the details of the enabling legislation, and this is all too often in the hands of lobbyists.

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Endnotes

1 The multiplier is a macroeconomic effect where stimulus income/loans are spent by businesses and then employees of those businesses spend their salaries and so on, depending on the propensity of the consumer to save, each dollar can be spent multiple times, boosting the economic impact of the government stimulus/lending.

2 $700 billion * 80% paid out to employees / 1- .9 marginal propensity to consume.

3 GEM Research: U.S. Entrepreneurs Vulnerable in Economic Downturn; Latest ***GEM Study*** Looks at US Minority Entrepreneurship, PR Newswire, New York, November 18, 2008.

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7. Teaching pedagogy and content articles
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Please include a cover page with all the authors' contact detail. The second page should include 50-75 words biographies of participating authors. Articles submitted should follow *JIBS* referencing style of consistency.

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