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Trade

Civilizations die from suicide, not from murder.
—Arnold Toynbee

Trade is an extremely important part of our economy. Like other economic structures, outputs and inputs must equal to retain parity. When imports exceed exports, a trade deficit results and wealth flows out of the economy, reducing dollars available to add value and fuel expansion and additional wealth within the economy. When a high deficit accumulates in one country, such as China, we will eventually lose not only manufacturing capability but political and trade advantage. This is elementary information, but it seems everyone has a different interpretation of our trade situation and how to deal with it. Metrics will be used to help in gaining and sharing perspective.

Market-Driven Economy

It is the purported philosophy of the United States to promote free trade. The concept is that all artificial barriers are removed and the road to smooth commerce is paved with shared opportunities for everyone. Tariffs equalize the monetary value between the participants. The effect is a two-way flow of trade. To this extent, the United States negotiates trade agreements with different countries that supposedly provide some level of parity. Again, the theoretical intent is to maintain inputs and outputs within reasonable parameters.

Technology Transfer

Trade involves technology transfer as well as goods and services. A goodly portion of the technology transferred to China was paid for by the taxpayers and has both a commercial value to the citizens and a military value. The way we share this technology determines our margin of safety and the degree to which our technological advantage is wasted, as well as opportunities to profit from our investment.

Market Driven Economy

In a market-driven economy, all must live with the vicissitudes of supply and demand. Consumers want low prices. Production supplies the product from the lowest cost source, consistent with the ability to service customers and comply with their business model. The less the consumers pay for one item, the more they can buy. This helps to constrain inflation. It is also the key argument when the trade deficit is discussed.

Buying low (outsourcing) and selling high (American markets) increases profit and stockholder equity. That is what capitalism is all about. The current negative effects are the transfer of wealth from our system into our competitors and the loss of associated jobs. At earlier points in history, this transfer of wealth flowed to America, creating both great wealth and a middle class.

Population

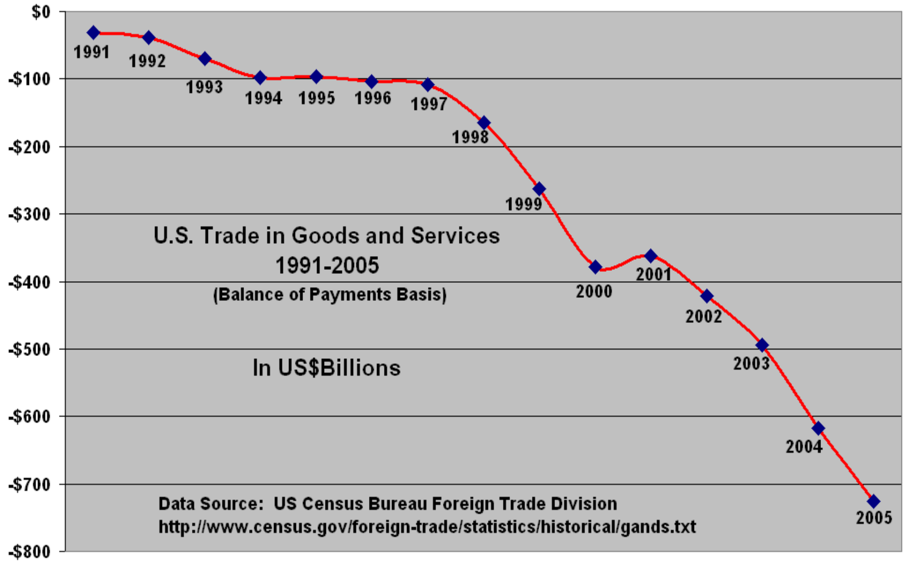
Population is a critical analysis input. As the following chart indicates, the United States has only 4.6 percent of the world's population. China and India have 37 percent. If every person in China and India had the same standard of living, their total economies and resource use would be proportionate. The price and availability of oil are key issues. While the major oil-producing countries play a critical role in global competition, their small population keeps them off the chart.

Country	Population	%	Cum %
Total World Population	6,446,131,400		
People's Republic of China	1,306,313,812	20.3%	20.3%
India	1,080,264,388	16.8%	37.0%
European Union	457,030,418	7.1%	44.1%
United States	297,200,005	4.6%	48.7%
Indonesia	241,973,879	3.8%	52.5%
Brazil	186,112,794	2.9%	55.4%
Pakistan	162,419,946	2.5%	57.9%
Bangladesh	144,319,628	2.2%	60.1%
Russia	143,420,309	2.2%	62.3%
Nigeria	128,771,988	2.0%	64.3%
Japan	127,417,244	2.0%	66.3%
Mexico	106,202,903	1.6%	68.0%
Philippines	87,857,473	1.4%	69.3%
Vietnam	83,535,576	1.3%	70.6%
Germany	82,468,000	1.3%	

Population – Source data Wikipedia

How Are We Doing in the Global Competition?

For all of these reasons, the balance of trade is an indicator of the health of any economy. The following chart shows how well America is performing in the marketplace or in contemporary terms, how well we are faring in the global economy? These inputs (imports) and outputs (exports) are communicated through metrics. Like most metrics, these reflect symptoms and not causes,



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U.S. Trade in Goods and Services

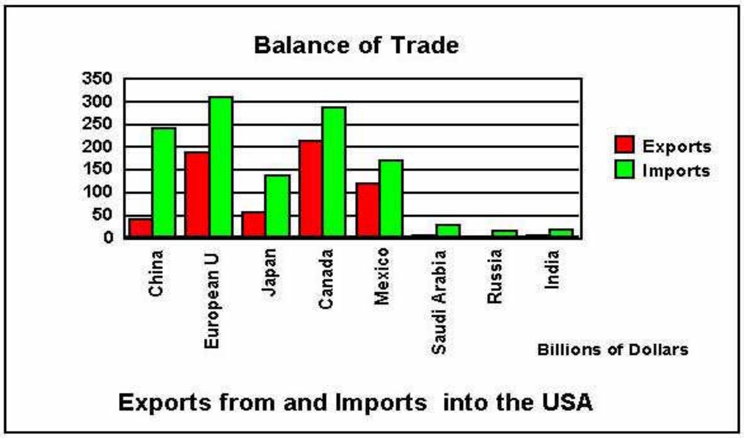
Other than a blip in 2001, the trend has been sharply down since at least 1997. While the American political parties point fingers at each other for the transfer of wealth and jobs, the chart clearly shows it has been perhaps the one truly bipartisan issue, spanning several presidential administrations. We ended 2005 with a deficit greater than $700 billion. The following chart provides a slightly finer granularity. The total deficit on the chart is roughly 80 percent of the deficit and our most significant trade partners are less then 10 percent of the nations with which we trade.

Core Trade Information By Country

Country	Exports	Imports	Deficit
Canada	211349.0	287870.2	-76521.2
European Union	186342.3	308769.0	-122426.7
Mexico	120048.9	170197.9	-50149
Japan	55409.6	138091.2	-82681.6
China	41836.5	243462.3	-201625.8
India	7958.0	18807.5	-10849.5
Saudi Arabia	6829.7	27227.7	-20398
Russia	3942.3	15278.6	-11336.3
	633716.3	1209704.4	-575988.1

Trade Information by Country - U.S. Department of Trade

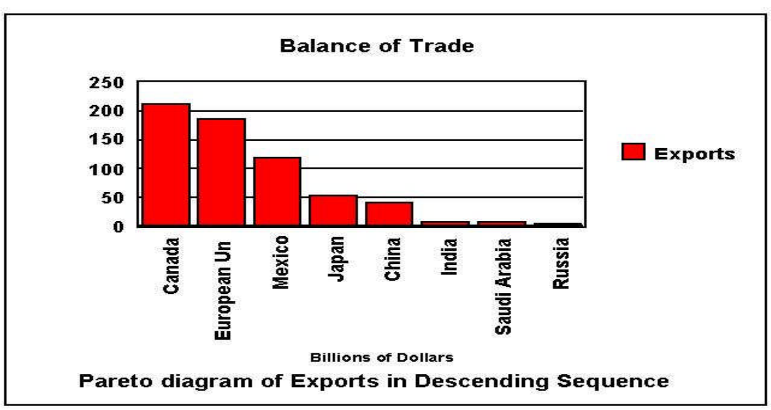
The most obvious observation is our unfavorable balance of trade with all major trading partners. Grafted, the differences between imports and exports are shocking. A Pareto chart shows the deficit in descending value. If there is any surprise, it is that the European Union ranks number two (2) in the deficit value.



Trade Deficit by Country

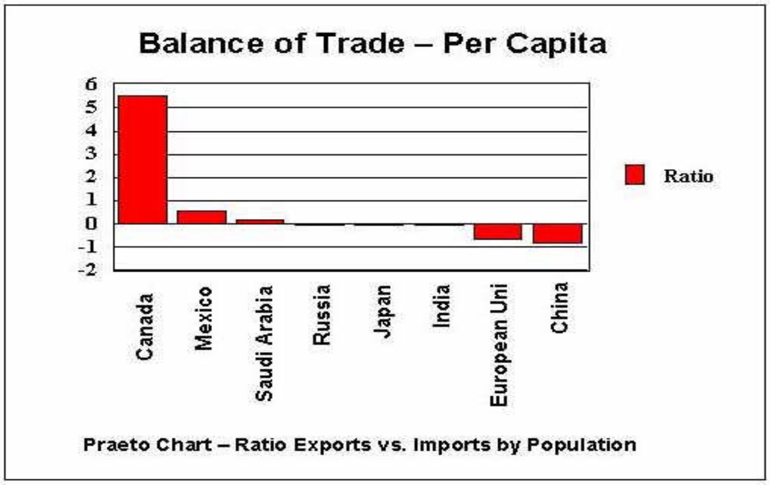
Obviously and of absolutely no surprise is the dominant role that China plays in our deficit. As discussed in the chapter on China, they have little incentive and even less intention to resolve the deficit. Plainly put, they do not have to. For all intent and purposes, America is more of an economic hostage to China than to the oil-producing countries. Please note that the deficit America runs with Saudi Arabia is only slightly greater than 10 percent of the one with China, a very manageable level.

The corollary chart shows that our best international customers are Canada, the European Union (EU), Mexico, Japan, and then China. India, Saudi Arabia, and Russia barely make the list. Altogether, it appears that NAFTA accomplishes a balance of trade, at least on a per capita basis.



Balance of Trade

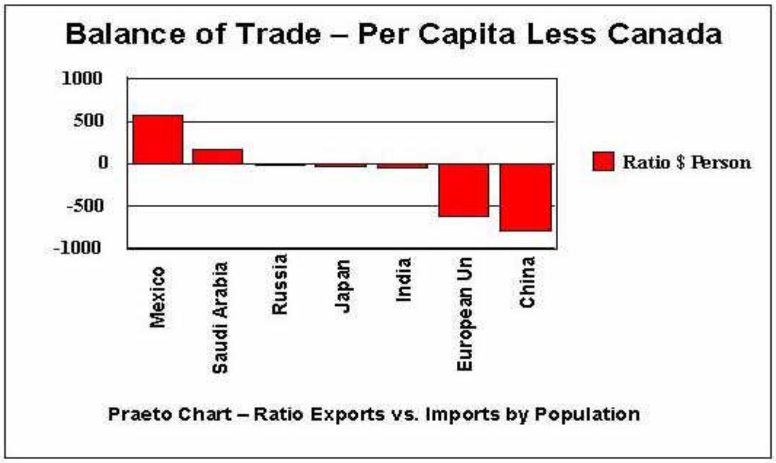
If the analysis were stopped at this point, it would present the wrong impression and fail to make several critical points. A different view was obtained by calculating the per capita balance.



Balance of Trade Per Capita

This analysis shows that without the NAFTA countries, our balance of trade would be more significantly more negative.

On a per capita basis, Canada is a great customer who does not get the respect or attention they deserve. Canada is so dominating they were backed them out of the chart in order to see the others more clearly.



Balance of Trade per Capita Less Canada

The Japanese Miracle

Back in the 1980s, all of American industry flinched at the power of the Japanese miracle. They were going to take away jobs and displace the United States as the dominant manufacturing power. What few people understood was the diminishing return based on their population size and the rapidity with which they reached cost parity. Although the United States runs a two-to-one unfavorable import/export ratio, with a 127.4 million population, their imports per person are on parity with ours. Obviously, their production systems are more efficient than ours, but they unfairly restrict American factories. In spite of distribution difficulties, on a per capita basis, they are excellent trade partners with opportunities to increase trade.

Emergent China

Today, we look at China in much the same way; but the rules are significantly different. With 1.3 billion people in an export mode and growing at their current rate with virtually no restrictions, they can eventually overpower and marginalize us. No cap exists on the potential size of the trade deficit and the eventual damage it will do to the American economy. Somewhere, in some way, the flow of the American economy into China and the EU must be slowed and if possible, reversed.

While we focus on China, our trade deficit per person with the EU is 80 percent that of China. In other words, we are faring nearly as poorly with the EU as we are with China. This is sobering information and speaks volumes to our lack of attention to Europe.

Analysis

Perhaps the most disconcerting findings in this analysis are what we do not see. That is, trade with the Southern Hemisphere, specifically Central and South America is relatively nonexistent. Given the high percentage of Latino population in the United States, one would think that we have an advantage in our own hemisphere. If we do, we certainly have not been able to take advantage of it.

Perhaps the most critical point is that we have focused far too much effort toward the big future markets of China and India. American industry needs to be involved with both of these emerging countries; but until they develop consumer-oriented distribution systems and create internal jobs at the required rate to sustain their growth, they are not going to reach their potential as the huge market we all salivate over. In the meantime, other markets and opportunities are defaulting to our competitors.

Multinationals

Economists logically make the argument that multinational enterprises based in the United States are not properly reflected in the government numbers. Their point is that imports are improperly stated because sales from their offshore factories are counted as imports while they should be domestic sales. In addition, products sold to countries other than plant location are not counted as part of exports.

For the most part, this is an academic argument. The major issue is the recycling of dollars within our economy, where value is added, and where jobs are created. They argue that domestic jobs are created and in many cases, it is true. In others, they replace jobs in our economy and move them to a different economy. This means the multinationals have to be viewed from two dimensions.

The first is an investor viewpoint. The multinationals are very sensitive to the cost of product. This is extremely good news for the bottom line, investors and prudent savers. They have been well served in the global economy because the rate of exchange with China is severely distorted. These population categories have the best of both worlds—they get an excellent return on investment while saving money on products.

The second is from the worker's viewpoint. They see jobs outsourced to China, India, and elsewhere. These displaced workers frequently take lower-paying jobs although their cost of living continues to rise. For these financially strapped consumers, the economy has not been good. Lower paying jobs allow them to purchase low price products but they have little conviction that things will improve. This defeatism contrasts sharply with the optimism we observed in China. Normally both partners work but it is more difficult to make ends meet. It must be stated that expectations constantly rise as well. The expectations of an American family are much higher than necessity would dictate because they are based on a consumer perspective.

Germany and Japan prove highly industrialized countries can compete. As a point of fact, Germany is the largest exporter in the world, not China.

The data indicates that American companies have not focused enough effort on countries other than China and India. Canada, because their economy is heavily integrated with ours, is frequently taken for granted. China has certainly taken advantage of our neglect. They are making deals to acquire chunks of the coveted Canadian oil sands. They are also very busy all over the globe, making deals on virtually every type of material and looking at every market.

Outsource Where Necessary

Outsourcing is, and will continue to be, a viable strategy. Like exporting, importing does not occur in a vacuum. The need is to understand the cost and time to market. Of equal importance is developing the true cost and time to acquire and get the products.

In the attempt to lower production costs, many companies have found that savings are significantly less than projected. One of the reasons is they have never calculated the true total cost of ownership. This is partially a failure to perform detailed maps of the process and partially because the actual cost are spread all over the financial statements.

The plan needs to spell out optional sources along with the opportunities for increased sales. A critical step is to chart the total lead-time step by step and time phase it. The second step is to define the market and customer impact of the total lead-time. The most critical factors are time to market and flexibility.

If the company model is low-cost supplier, there are significant outsourcing opportunities. At the same time, products and markets are at risk in the global economy. With the high rate of low-cost knockoffs available to customers that buy on price, than business survival is an issue.

If your company model is custom, quality based, or high end, customer service is the key mission. Off shoring to reduce cost while decreasing customer service and flexibility is a very dangerous game. Some CEOs fall into the “slow boat from China” syndrome. Airfreight from China (or elsewhere) can transport virtually any product anywhere in less time than by truck or ship. The only competitive advantage may be the cost of airfreight versus ground or container.

Technology-driven companies need to be very careful about what and from whom they source, especially multiple parts or complete products from China. Custom manufacturing and engineering to order companies are also facing global competition every day. Today, there are few lead-time advantages between countries.

With the increased political focus, the Made-in-America bias may resurface. The rapid decline of the dollar against other world currencies is already fueling exports. As some point, the off shoring cost advantage may disappear but the long replenishment times will remain.

Increase Exports

American companies are and should compete in the global economy by significantly increasing their focus on exports. We worry about competition instead of taking it to our competitors. The doors opened by the global economy are not equally open to us, but we need to pound on them all.

While staying connected to China, enterprises need to shift some market focus to South America, Eastern Europe, and other Asian countries. Our government trade policies and agreements need to facilitate and enable export opportunities while preserving the integrity of the American factory system.

Analyze domestic customers with a fresh viewpoint. It has long been proven that the best place to increase sales is current customers. Domestic companies may be having a problem competing against offshore companies as well. Their loss or movement to other locations is a loss of business to your company. Consider implementing programs that improve the competitive position of your enterprise and those of your customers and suppliers. Because collaboration is so important, we will focus some time on understanding what it is.

Supply Chain Collaboration

Supply chain collaboration programs tighten up the two systems of participants by improving communications, product development, and collapsing time. In some cases, there may be opportunities to independently spin off services that can be shared by multiple companies.

Form Regional Business Consortiums

Join in regional business consortiums. In Wisconsin, eighteen counties have formed a collaborative enterprise called "the New North." It involves manufacturing, government, energy, education, and institutions coming together to reengineer a new, tightly integrated system that reduces the inefficiencies inherent in individual systems. By definition, it means a high degree of sharing and reworking internal systems to integrate with the consortium. Of significant importance, the multinationals are involved and are leading the way. In the New North, they have added jobs and helped smaller companies address problems. They are also leading the way in teaching and helping others to develop products and markets for export. One of their very enlightened approaches is energy sharing. Another is the recognition that in less than twenty-five years, the white population of America will be a minority. This rapidly changing demographic will change both products and markets. When this concept is extended, it means the Latino effect will be significant. It is curious then, with a growing domestic Latino population, that we still do not seem to understand the roughly 540 million population of Mexico, South America, and Central America—all within our own hemisphere. Just the difference in inventories and time to support customers or suppliers are considerably reduced from Asia. Why the lack of attention?

Companies should consider the following:

- Develop the will to export into the global marketplace.
- Research market needs.
- Define your competitive advantage.
- Determine how to leverage into the markets.
- Define internal changes required to support the initiative.
- Design and build products for selected export markets.
- Implement the capability.

Summary

History has proven that more wars are lost because of policies and bureaucracy than by the troops in the field. This analogy has great application in today's competitive environment. Many of the competing nations have established policies that create an unleveled playing field for our manufacturing companies. It is most remarkable that our national trade policies do not include the most elemental of concepts—reciprocity.

Our government is doing little to back our manufacturing enterprises by enforcing trade agreements. Unlike the military, we choose who our leaders will be. Every two years, we have the opportunity to elect responsible persons of all parties that will support our national need to stay competitive. Do not waste the opportunity.

Government is always an easy target; but certainly, consumers and industry share an equal amount of responsibility. Our consumerism drives China's commodity-based production system. America is the only industrialized country in the world with declining miles per gallon. Foreign competition is not responsible for that. We somehow blame China for eating into our oil supplies. When the price of gas increases, people angrily blame the Congress and the president instead of taking responsibility for the significant roles we all play.

In any competition, to the victor go the spoils and the ability to shape history. That may well apply to global competition. Personally, we would rather have Americans shape our future, not countries that deny their citizens' basic freedoms.

In most globalization discussions, two subjects come up. The first is outsourcing for products. The second is lamenting the loss of jobs. It is remarkable that people intellectually understand the connection but do little to address either one. There is fatalism in our attitude. What is not heard is, "We are effectively exporting to markets around the world."

That is precisely what we should be doing.

By Wayne L. Staley