

Japan's Troubled Economy

How Has It Affected Tennessee?

by Steven G. Livingston

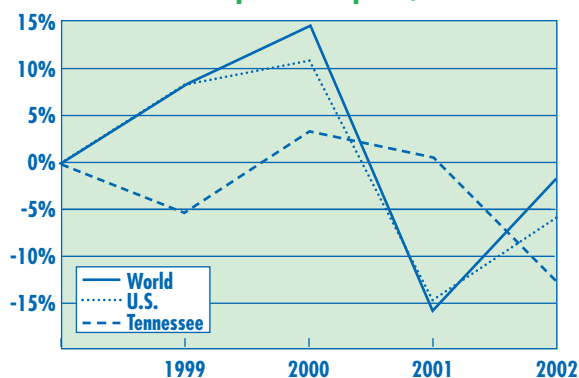
A dozen years ago Japan's economy was the envy of the world, and commentators touted Japan as Number 1. In the event, the prediction was premature. Japan has now suffered more than a decade of economic stagnation and, more recently, deflation. Its economy today could be more accurately described as the worry of the world. Tennessee has long had close economic links with Japan. How is that country's distress affecting the Volunteer State?

Japan is the state's largest foreign investor. As recently as 1996, it was the state's second largest foreign trade partner. So Tennessee has a lot at stake in Japan's continuing economic difficulties.

Japanese firms have invested nearly \$2 billion in Tennessee. (The contours of this investment are covered in *Global Commerce*, volume 5, no. 3.) The large Japanese multinationals are doing well in the United States and are continuing to reinvest in the state, but new investment from Japan, so important a part of the state's economic growth 15 or 20 years ago, is drying up. The number of new Japanese-owned businesses in the state has fallen precipitously over the last 10 years. This is one important reason why Tennessee has lagged the nation in attracting foreign investment in recent years.

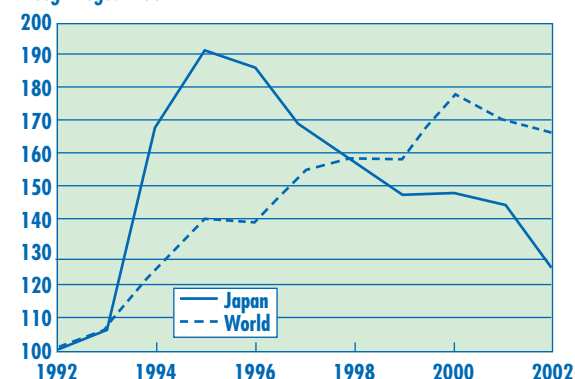
The effect of the Japanese slowdown on state exporters is equally clear. Japan has slipped from being Tennessee's second largest market to its fourth. At current rates, Germany appears poised to also pass it in the near future. At its height, Japan accounted for more than eight and a half percent of all state exports. Today, Japan purchases less than five percent of Tennessee's exports (\$283

Growth Rate of Japanese Imports, 1998-2002



Tennessee Export Index: Japan vs. the World

Through August 2002



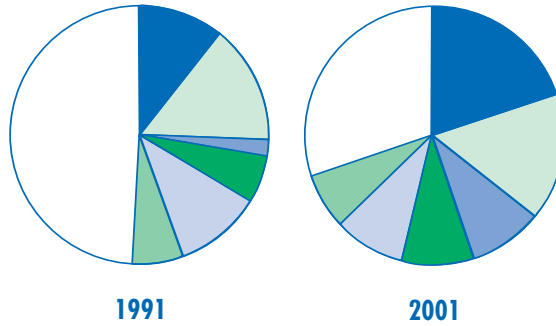
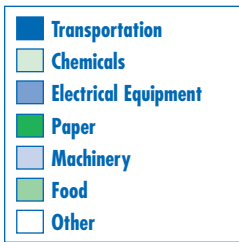
million in the first half of 2002). This is the largest percentage drop of any nation with which Tennessee trades. If Japan were still buying at the relative levels of the mid-1990s, Tennessee's annual exports would be more than \$400 million higher. That is a sizable hit for this state's economy!

As shown in the first chart, in recent years Tennessee has experienced less volatility in the Japanese market than either the rest of the United States or the world, but the underlying trend is the same—down. Looking over the past 10 years, we

Japan has slipped from being Tennessee's second largest market to its fourth.

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A Changing Export Profile



Japan

continued from front

Transportation, chemicals, and electrical equipment have been steadily increasing their share of state exports to Japan over the past 10 years.

see that state exports to Japan turned down sharply in 1996 and, in real terms, have been falling ever since. This is almost the inverse of the global trade picture where, for the most part, Tennessee has steadily increased its exports. Though exports to Japan have grown over the decade, they have grown less than half as fast as Tennessee exports generally.

The percentage of Tennessee exports going to Japan has actually fallen faster than the percentage of total American exports that go to Japan. In part, this is because of the composition of Tennessee's

exports. Ten commodities account for half of the state's exports. Auto parts alone make up close to one-fifth of all sales to Japan. Auto parts and cotton-based exports combined constitute a quarter of exports. State exports are significantly more concentrated in a small number of industries than are overall U.S. exports. Note how dominant the state is in several export categories: potato chips, cellulose, and synthetic yarns, for example. Unfortunately these have not recently been products with dynamic sales in Japan.

The pie charts provide further evidence of this concentration. Three industries—transportation, chemicals, and electrical equipment—have been steadily increasing their share of state exports to Japan over the past 10 years. This concentration, however, is not so much the result of the spectacular success of these industries over the past 10 years as that they have been able to avoid the export losses suffered by so many other sectors. (The automotive industry is something of an exception here. It did grow rapidly until the late 1990s, the result of the location of Nissan and many Japanese auto parts plants in this state. However, even automotive exports have been flat since 1997.)

What does the future hold for state exporters? The largest mystery, of course, is when and if the Japanese economy will pull out of its long slide. At present, there is no evidence upon which to anticipate a sudden turnaround. Assuming a stagnant market, the question then becomes: which products will buck the tide and continue to grow in such a market? The accompanying chart lists the major Japanese import sectors that have posted positive growth numbers every year since 1997. Presumably these are the best products to be selling in Japan. At first glance, the list does not appear to mesh well with what Tennessee is selling. However, certain items such as medicaments (various medical goods and medicines), heterocyclic compounds, and parts for pipes and tanks do offer possibilities for state exporters. These are all goods currently being exported out of the state.

The flip side is those products that are suffering the worse reverses in Japan. Once again, the list of the most poorly performing major Japanese imports does not mirror the profile of Tennessee's exports, in this case good news for the state. Yet several state industries, most prominently lumber and whiskey, look to face increasing difficulties selling to Japan. (This may be the only tough market for the whiskey industry, which has had very good export growth numbers recently.)

In sum, the Japanese economic slowdown has cost this state in the form of decreased investment in new plants and facilities and a substantial reduction in production due to the lack of growth

Losing Ground (\$millions)

2001 Imports	
Frozen Fish	\$2,552
Unmilled Wood	\$1,877
Plywood	\$1,700
Machines	\$1,462
Diamonds	\$992
Wine	\$789
Spirit Beverages	\$783

Steadily Growing Imports (\$millions)

2001 Imports	
Pork	\$3,376
Medicaments	\$2,718
TV and Radio Parts	\$2,100
Heterocyclic Compounds	\$2,059
TV and Radio Trans. Apparatus	\$1,011
Prepared Meats	\$880
Electric Heaters	\$778
Pipe and Tank Parts	\$708
Blood, Antisera, and Vaccines	\$684

Tennessee's Top 10 Exports to Japan (2002 Jan-July Exports)

	(mil\$)	% State Exports	% U.S. Exports*
Auto Parts	\$57.55	17.52%	8.50%
Medical Instruments	\$16.40	5.00%	7.27%
Cotton	\$15.19	4.63%	32.34%
Cotton Linters Pulp	\$12.91	3.93%	20.31%
Orthopedics	\$14.77	4.50%	1.73%
Computers and Equipment	\$12.50	3.80%	0.15%
Prepared Potatoes	\$11.09	3.38%	82.71%
Cellulose	\$9.22	2.81%	54.76%
Electric Motor Parts	\$8.80	2.70%	36.82%
Synthetic Filament Yarn	\$8.49	2.58%	41.06%

* % of total U.S. exports to Japan that come from Tennessee

2nd Quarter 2002

Automotive exports remain a bright spot.

2nd Quarter 2002

Telecommunications exports suffered heavy reverses.

Exports to China doubled this quarter.

Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$784,029,719	28.1%	16.8%
Chemicals	\$423,167,755	1.9%	23.3%
Non-Electrical Machinery	\$331,514,904	-12.4%	18.1%
Computer and Electronic Products	\$313,323,725	-19.1%	-6.3%
Agriculture	\$177,514,524	66.4%	11.9%
Miscellaneous Manufactured Goods	\$136,453,474	15.3%	1.5%

What's Hot and What's Not?

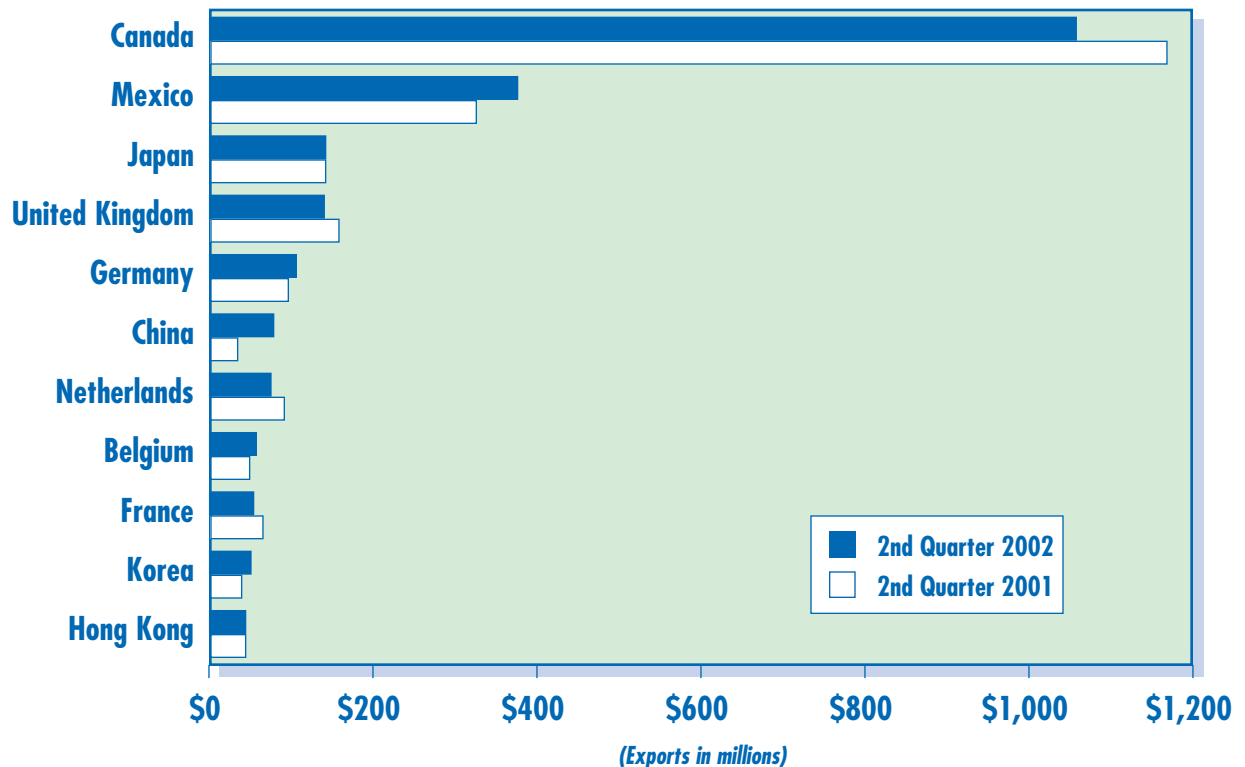
(among Tennessee's top 100 exported goods)

	Value of Exports	Growth	Decline
PRODUCTS WITH THE GREATEST GROWTH			
Orthopedic Parts	\$20,702,054	*	
Artificial Joints and Parts	\$11,092,036	*	
Digital Monolithic Integrated Circuits	\$6,606,727	*	
Coated Paper and Paperboard	\$7,606,509	*	
Video Games	\$8,694,692	201,969.0%	
PRODUCTS WITH THE GREATEST DECLINE			
Electronic Calculators	\$516,652		-97.9%
Special Canadian Re-exports**	\$6,668,381		-93.7%
Electric Telephonic Apparatus	\$4,279,375		-69.1%
Electrical Apparatus Parts for Telephone Line	\$43,910,700		-61.3%
Internal Combustion Engine Parts	\$20,036,958		-59.6%

* Not exported last year

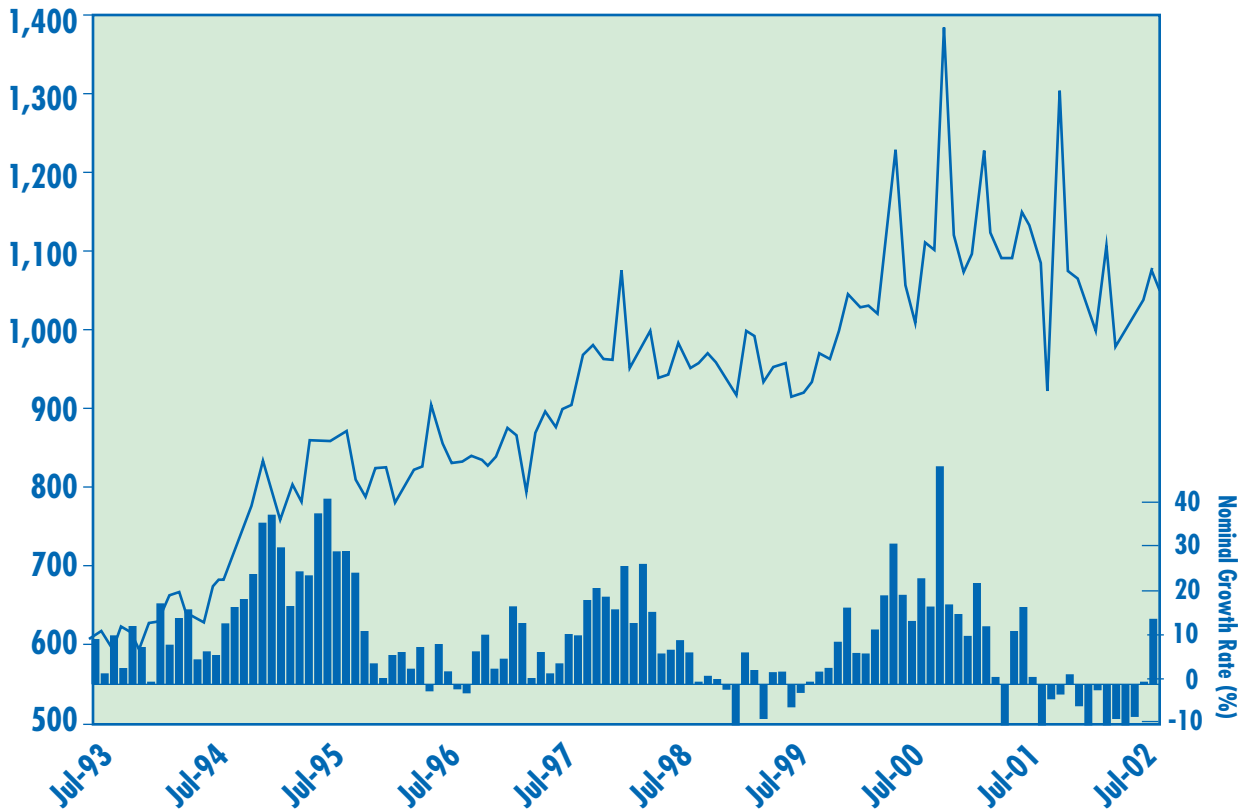
** Includes software and goods returned for repairs or other reasons

Tennessee's Leading Trade Partners



Tennessee's Monthly Exports

Exports in \$ Millions



(Seasonally adjusted, expressed in 2000 dollars)

2nd Quarter 2002

GlobalCommerce

Global Commerce: Tennessee and the International Economy, published quarterly by the Business and Economic Research Center, Jennings A. Jones College of Business, Middle Tennessee State University, is available free of charge to interested individuals and institutions.

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Fastest Changing Export Destinations

(among countries averaging more than \$2 million in sales per quarter)

	Value of Exports	Gain	Decline
COUNTRIES WITH THE GREATEST GROWTH			
Indonesia	\$27,579,459	199.9%	
Switzerland	\$17,190,273	124.4%	
U.A.E.	\$7,952,501	103.8%	
Saudi Arabia	\$24,516,899	101.3%	
China	\$90,954,023	100.2%	
COUNTRIES WITH THE GREATEST DECLINE			
Egypt	\$4,854,349		-84.3%
El Salvador	\$3,052,567		-79.1%
Norway	\$1,274,971		-52.8%
Guatemala	\$6,788,461		-52.0%
Singapore	\$55,403,656		-35.7%

Tennessee International Trade Report

One industry, automobiles, is actually posting significant export growth.

By the barest of margins, Tennessee exports have reversed their recent downward slide. At \$3.027 billion, second quarter exports were up a meager \$1.5 million from a year ago. This was the best quarter for state exporters in a year. A strong July (exports up more than 14 percent from 2001) gives further hope that the tide is turning.

However, it has been a very tough year indeed. Tennessee exports have given up all of their gains of the past three years. Even the comparatively good second-quarter figures hide a number of continuing problems in the state's export sector. This is because one industry, automobiles, is actually posting significant export growth. Rebate and zero-financing programs have maintained the North American demand for cars and trucks. As a result, Tennessee's auto and auto parts exports to Canada and Mexico grew by more than \$200 million last quarter. The transportation industry now accounts for more than a fourth of Tennessee's total foreign sales.

But this means, of course, that the rest of the state's exporters lost about \$200 million during the quarter. Without the auto industry, state exports fell more than seven percent from 2001—but it gets even worse. Thanks to huge purchases in Turkey and Southeast Asia, Tennessee cotton exports also soared 85 percent for the quarter. Subtract that additional \$75 million gain, and the rest of the state's industries lost \$275 million (11 percent) from 2001.

This isn't to say that no other sectors prospered. Computer and laptop exports were up 250 percent (to \$51 million) thanks to heavy purchases in Malaysia, Ireland, and Japan. A large Saudi Arabian sale boosted aluminum plate exports to \$33 million. Color pigment exports nearly doubled

(also to \$51 million) because of sales in Canada and Belgium. Tennessee's most reliable export, sour mash whiskey, turned in another of its clockwork-like increases, this time growing 18 percent to \$48 million.

Generally Tennessee exporters were lucky to hold their own. A number of industries suffered serious setbacks in foreign markets. The largest export losses were in the line telephony industry. The telecommunications crash has hurt this sector badly, and it lost more than \$100 million in exports this past quarter. The paper, electronic calculator, and apparel industries each lost more than \$20 million from a year ago.

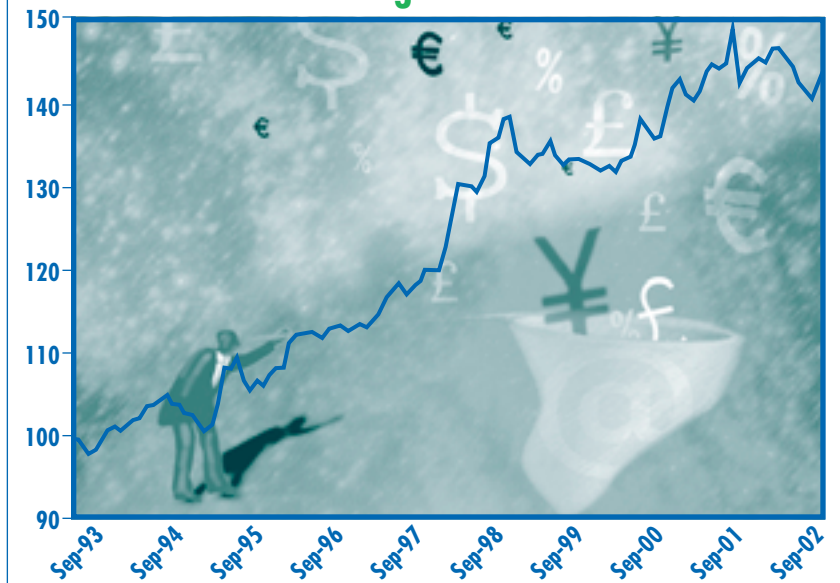
These losses were spread across many markets. Indeed, Tennessee's foreign sales increased only in East Asia this past quarter, due to one country. Though the Japanese, Hong Kong, and Taiwan markets were essentially flat, exports to China doubled. This singular performance is particularly interesting because it was not limited to one industry, nor was it a one-time sale of some product. Chemicals, electronics, cotton, and machinery exports to China all posted sizable increases. In southeast Asia, a large loss in Singapore (something of a statistical fluke—that country completed a large one-time purchase of engine parts in the second quarter of 2001) masked generally good performances elsewhere in the region.

The two big markets, NAFTA and Europe, yielded no growth at all. The euro area of the European Union (EU) did purchase an extra \$3 million dollars in Tennessee products, but this was more than swamped by a loss of \$16 million in the U.K. The latter was largely due to an 85 percent decline in sales of paper products (\$17 million). Thanks to the robust auto industry, Mexican exports were up a solid 15 percent (\$50 million), but autos alone could not save Canadian sales, which fell double that amount (\$100 million).

Latin American exports fell modestly (\$190 to \$181) which, given the current economic difficulties in that region, probably ought to be counted as good news. As expected, Argentina was the most difficult market. Though organic chemical exports were actually up, most other Tennessee exports to Argentina have fallen virtually to zero. The desperate strait of the state's apparel industry is reflected in large declines in women's clothing sales in El Salvador and Guatemala. These countries contain factories that are integrated with Tennessee firms in the production of these apparels.

Any dramatic change in Tennessee's export picture awaits the end of the global recession. The small tailwind provided by the recent (and apparently temporary) decline of the value of the dollar does not seem to be greatly assisting local exporters. The July numbers do suggest, however, that perhaps the bottom has been reached. ■

Tennessee Trade-Weighted Dollar Index



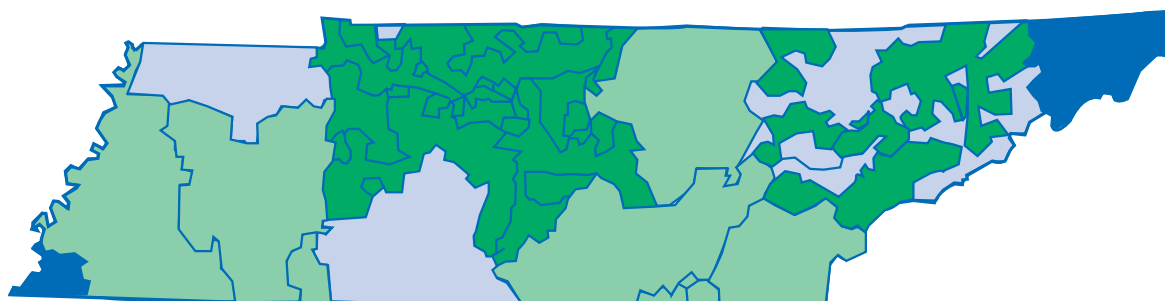
Japan

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in the Japanese market. The best that can be said is that Tennessee appears to be only slightly worse off than other American states as a result of this circumstance. The medium-term future seems to sug-

gest more of the same. There will not be a dramatic drop-off in exports to Japan, merely an uphill battle to maintain the existing level of sales to that country. This struggle has been a major factor in the relatively poor performance of state exporters during the past two years, and it shows how economic problems in a rather distant place can produce rather large effects in this state's economy. ■

Tennessee's Merchandise Exports by Three-Digit Zip Code, 1999



The Department of Commerce recently released information of state exports at the 3-digit zip code level. Shelby County and the Tri-Cities area remain Tennessee's most export intensive areas. Rural counties in all three divisions of the state continue to lag in their export performance.

Note: Tennessee's total merchandise exports in 1999 were \$9.3 billion.
Source: U.S. Department of Commerce, Exporter Location Series.

1999 Export Values
Millions of Dollars

- 1,000-2,722
- 500-1,000
- 250-500
- 93-250