

Global Commerce

Tennessee and the International Economy

Trade Wars

by Steven G. Livingston

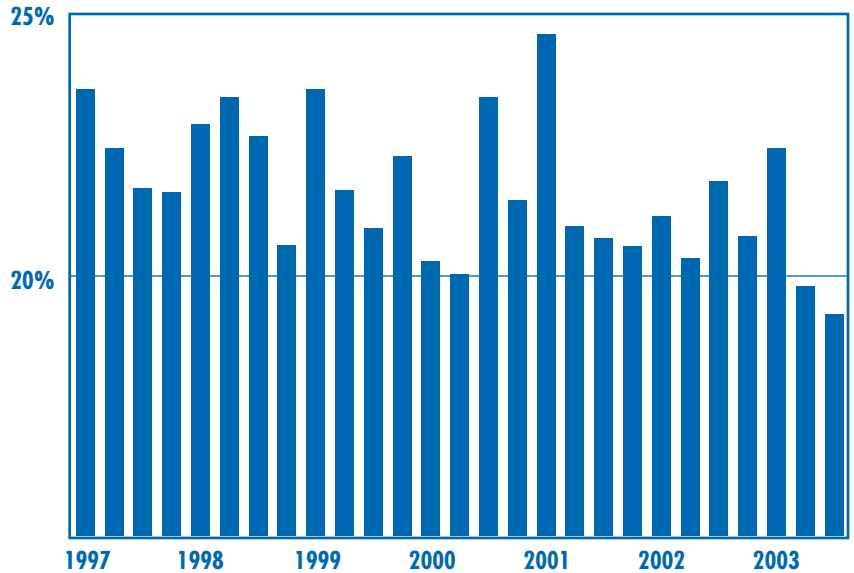
It is ironic that the World Trade Organization (WTO), designed to “domesticate” international trade disputes, has instead been the instigator of a succession of bitter trade conflicts. President Bush’s decision to rescind the steel industry safeguards he had imposed rather than face very costly global trade sanctions is the most recent of several last-minute retreats from a global trade war.

The WTO features two institutional innovations, and each has played a role in shaping current trade conflicts. First, the WTO has a binding dispute settlement mechanism. One country can complain about another’s trade practices and obtain a final verdict as to whether or not they are in fact illegal. This has ended the days of dragging out trade disputes seemingly forever. But a final decision also creates a deadline, and deadlines often sharpen conflict. Second, if the loser in a trade dispute does not change its practices to conform to the WTO decision, the aggrieved party is allowed to place additional tariffs (“trade sanctions”) on goods produced by the loser up to the value of the purported harm done by its violations of international trade law. In fact, the loser seldom wishes to change its policies, and the winners have found that threatening these sanctions can be an excellent way of forcing the loser’s hand. The threat of trade sanctions has become more common, resting on the unstated assumption that the loser will back down. But what if it doesn’t? Either sanctions are enforced or a trade war erupts.

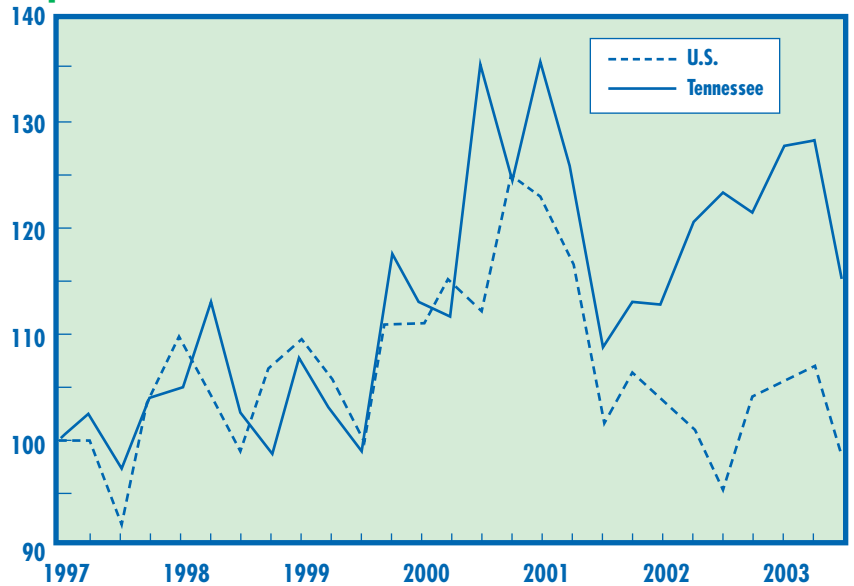
Exporters and their goods are the pawns in this battle of nerves. Sanction lists can involve several billion dollars’ worth of commodities and undoubtedly would inflict real harm on exporting firms and their local economies. How much damage? To get an idea, let’s look at the potential impact on Tennessee if the European Union (E.U.) should actually impose the tariffs on the list of sanctioned commodities it has issued as part of the Foreign Sales Corporation (FSC) case.

A Waning Market?

The Percent of Tennessee Exports Going to the E.U.



Export Growth to the E.U.: 1997-2003



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Trade Wars

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E.U.-U.S.: The Critical Trade Relationship

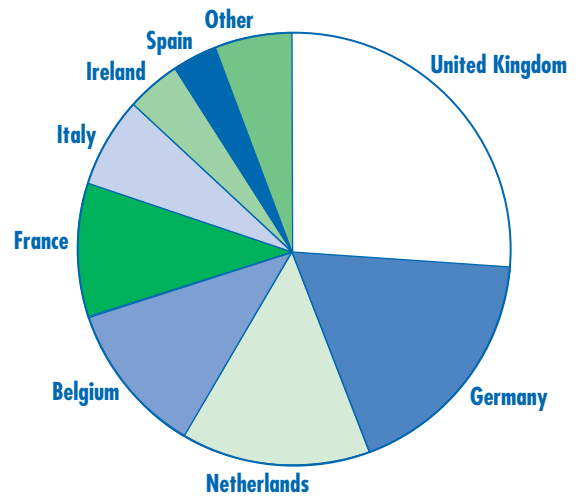
In most circles, President Bush's decision not to defy the WTO ruling on steel was greeted with sighs of relief. The E.U. had already announced draconian tariffs on \$2 billion of U.S. exports beginning in March 2004. Japan then announced its list valued at \$85.2 million, and China followed with a list valued at \$94 million. Brazil and other complainants were sure to have followed suit. But the size of the E.U. list (and the fact that it was the leader in issuing a list) points to the fact that the most critical global trade relationship remains that between the E.U. and the U.S. This is the likely flash point of any future trade war.

Tennessee, too, depends upon its relationship with E.U. nations. About 21 percent of all Tennessee exports go there, roughly the same proportion as for the rest of the U.S. Tennessee has actually done a little better in European markets than has the nation in recent years. Total U.S. exports to the E.U. have not changed much over the past six years, whereas Tennessee exports have grown by about 10 percent. Though the E.U. is not the most dynamic of global markets and the percentage of state exports going there has actually fallen a bit, it is still easily the state's second biggest regional market, exceeded only by NAFTA.

Amazingly, in spite of this exposure, Tennessee would have suffered only slightly from the steel sanctions had they been imposed. One reason is that the state is not home to much of America's steel industry. (WTO rules stipulate that, where possible, trade sanctions should be within the same industrial sector as that of the claimed trade violation.) Another reason is that the

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Tennessee Exports by Country



E.U. focused the remainder of its sanctions on states that it regarded as battleground states in the 2004 presidential election. It apparently did not include Tennessee among these. (This effort to attract President Bush's attention follows a similar strategy used by the U.S. after its victory in a case involving the legality of an E.U. scheme to license banana imports into the E.U., when the U.S. targeted E.U. products very specifically to try to break up the E.U.'s political unity on the issue.)

The FSC Case

While steel has received all of the attention, an even costlier trade conflict is looming on the horizon. In 2001, the U.S. lost a huge case before the WTO involving American Foreign Sales Corporations, tax-favored legal entities that U.S. exporters could create to pay lower taxes on the income generated by their export sales. The E.U. claimed that this amounted to an illegal export subsidy, went before the WTO, and won. When the U.S. failed to completely end its policy (it did revise it), the E.U. announced, this past spring, a list of U.S. European imports to be sanctioned. A tariff of five percent would be imposed on a variety of U.S. goods beginning in March 2004. This tariff will rise by one percent a month, up to a limit of 17 percent, if the U.S. does not comply. It is estimated that these tariffs will cost U.S. exporters \$4 billion, double the amount at issue in the steel conflict. The U.S. is certainly aware of the stakes. But the House and Senate each have a different solution; to date they have been unable to iron out their differences and no action has been forthcoming.

If Tennessee escaped most of the steel sanctions, the same cannot be said for the FSC case. Some \$177 million in Tennessee exports is on the sanctions list, amounting to 7.2 percent of the state's E.U. exports and 1.5 percent of its global exports. These figures are substantially higher than for the rest of the U.S. Overall, just under three percent of all U.S. exports to the E.U. are on the list.

Tennessee Trade-Weighted Dollar Index



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3rd Quarter 2003

Laptops and PC exports were the quarter's best news.

3rd Quarter 2003

It was a rough quarter for state automotive exports.

Exports to Turkey soared in the third quarter.

Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$553,256,684	-22.4%	-21.5%
Computer and Electronic Products	\$481,664,188	49.9%	11.6%
Chemicals	\$397,230,364	-7.8%	-3.4%
Non-Electrical Machinery	\$287,236,571	-0.9%	-13.6%
Agriculture	\$256,171,538	70.8%	-24.1%
Miscellaneous Manufactured Goods	\$149,014,311	11.8%	2.0%

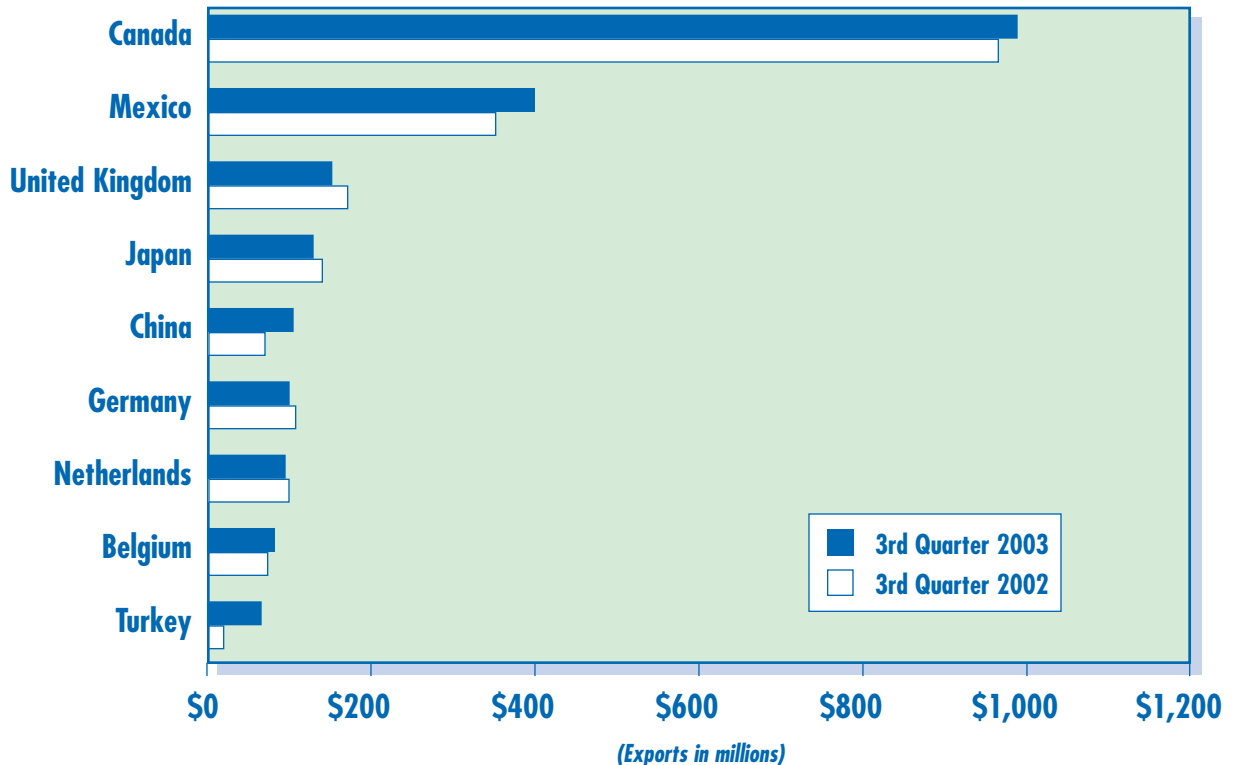
What's Hot and What's Not

(among Tennessee's top 100 exported goods)

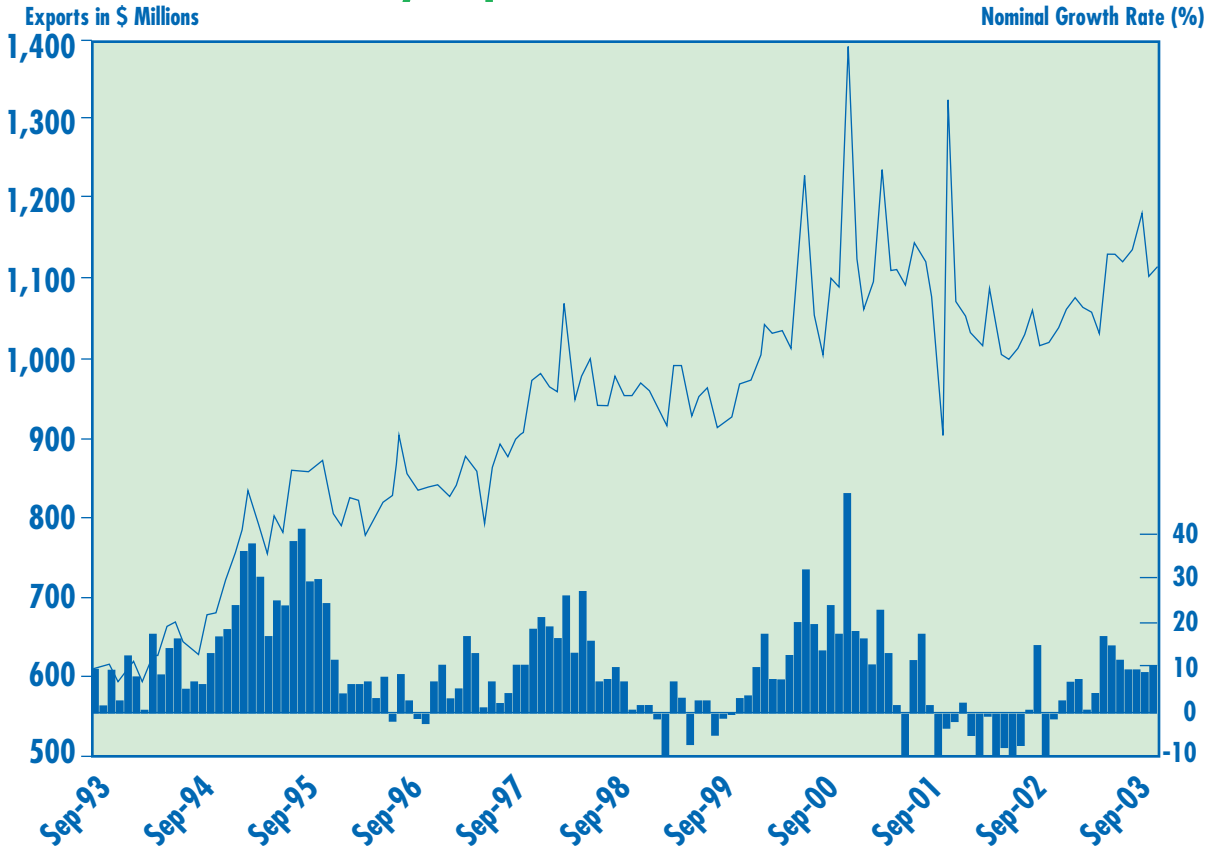
	Value of Exports	Growth	Decline
PRODUCTS WITH THE GREATEST GROWTH			
Computed Tomography Apparatus	\$10,673,750	76,425.3%	
Excavators	\$6,731,695	1,713.2%	
Electro-Diagnostic Apparatus and Parts	\$15,252,957	975.5%	
Internal Combustion Engines	\$9,115,259	741.6%	
Parts for Instruments Measuring Ionizing Radiation	\$28,386,465	729.6%	
PRODUCTS WITH THE GREATEST DECLINE			
Beverage Vending Machines	\$54,686		-97.7%
Gear Boxes for Cars	\$1,597,096		-86.6%
Passenger Cars	\$63,039,686		-56.7%
Parts for Elec. Apparatus for Line Telephony	\$16,286,539		-53.9%
Terephthalic Acid	\$9,972,926		-50.9%

* = not exported last year

Tennessee's Leading Trade Partners



Tennessee's Monthly Exports



(Seasonally adjusted, expressed in year 2000 dollars)

3rd Quarter 2003

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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			
Hungary	\$6,534,982	436.2%	
Russia	\$4,505,284	268.7%	
Turkey	\$70,050,197	218.0%	
Bangladesh	\$10,541,751	190.5%	
India	\$41,832,422	144.0%	
COUNTRIES WITH THE GREATEST DECLINE			
Venezuela	\$5,329,751		-62.3%
Dominican Republic	\$6,316,347		-51.6%
Saudi Arabia	\$9,456,688		-36.7%
Ireland	\$18,322,900		-30.3%
Spain	\$17,313,271		-30.2%

Tennessee exports were valued at \$3.053 billion for the third quarter of 2003, a 5.6 percent increase from 2002. This modest growth hides some dramatic swings among the state's major export industries. Huge declines in Tennessee's automotive exports were matched by equally sizable advances in the computer sector. Another big increase in cotton exports, combined with small but important gains by medical instrument manufacturers, was enough to push the state into positive numbers for the quarter.

The drop in automotive exports was remarkable. Auto parts sales were off by \$50 million, while exports of passenger vehicles were cut in half (dropping to \$63 million). The state lost an astounding 86.6 percent of its automotive gear box exports. The only bright spot was a large increase in automotive engine exports. However, this is tempered by the modest size of this sector of the auto industry. The state sold just \$9 million worth of internal combustion engines for the quarter.

Several years ago this would have ensured a very disappointing quarter for Tennessee. But computer sales have been skyrocketing. Foreign shipments of laptop computers grew 423 percent last quarter (to \$104 million), and PC sales were up another 184.3 percent (to \$54 million). Laser discs and music CDs, many of which will be played in those computers, just about doubled in the value of their foreign sales for the quarter, producing another \$45 million in exports.

Whipsawed between one exploding and one imploding export sector, Tennessee once again turned to cotton to ensure that the quarter's export numbers would be in the black. Cotton continued its recent phenomenal export growth. This quarter, sales of cotton were up 73.5 percent, from \$144 million to \$250 million. Turkey (up \$51 million), India (up \$25 million), Indonesia (up \$11 million), and China (up \$8 million) were the big purchasers. Most of these gains came in July, and presumably the state cannot rely upon them again next quarter.

A last sector worth commenting upon is the state's medical, scientific, and industrial instrument manufacturers. Medical instruments had a very good quarter. Sales of electro-diagnostic equipment (mostly to Germany), parts for x-ray apparatuses (to the Philippines and Singapore), and computed tomography equipment (which makes x-ray prints) were all up by more than 700 percent.

Geographically, state exports to the NAFTA market grew at almost the same rate as its global exports (5.77 vs. 5.6 percent). A modest increase in Canada (the site of the lion's share of lost automotive exports as well as most computer gains) was joined to a rather substantial 14.5 percent gain in Mexico. Computers and metal manufacturing accounted for the good Mexican numbers.

Thanks to cotton, South Asia actually turned in the best growth rate for Tennessee exports of any region during this past quarter. Exports to India increased from \$17 million to \$42 million, and both Pakistan and Bangladesh produced double-digit export growth. Elsewhere in Asia sales were flat. Japan was once again slightly down (from \$141 million to \$132 million), this time due to declines in automotive parts and paper sales. Mainland China, however, was the exception. Tennessee exports to China more than doubled their value of a year ago. The best news is that while cotton led the way, computer parts joined many other products in forging broad gauged gains in this rapidly growing market.

While most Latin American countries, most notably Brazil, purchased more Tennessee products, large declines in Argentina (terephthalic acid) and Venezuela (many products, presumably because of political uncertainty) meant that the state managed to eke out only a small gain in that region.

The best European performances were outside of the E.U. Hungary (Radio/TV transmission products) and Russia (plastics and artificial filaments) turned in the best growth numbers. The E.U. itself fell 6.53 percent (to \$587 million). Poor showings in the U.K. (down 10 percent), France (22 percent), and Ireland and Spain (both down 30 percent) were the problem. In only two E.U. markets, Sweden and Belgium, did the state see solid growth.

Finally, Iraq has once again become a market for Tennessee goods. The state sold about \$4 million in goods to Iraq during the third quarter. Most of these products still appear related to the American troops and the post-war effort (canned milk, soybean oil, etc.).

Looking to the future, the big question concerns the state's automotive exports. The state will need a turnaround in foreign shipments from this industry, long the basis of Tennessee's strong export numbers, to see significant overall export growth in the fourth quarter and on into 2004. ■

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One of the newer and odder export sectors is that of charitable giving.

"Charitable" Exports

One of the newer and odder export sectors is that of charitable giving. Because charitable donations have value, they must be registered just like any other product sent overseas. Tennessee has dramatically increased exports of charitable items over the past several years. Last quarter, \$20.6 million in charitable donations was sent out of state, 415 percent higher than 2002 and more than the combined amounts of 2000 and 2001. Most of this giving is to one of several Caribbean or Central American countries. Jamaica, Guiana, and El Salvador have been the largest recipients of recent Tennessee aid.

Trade Wars

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Prisoners of War? Most Affected Tennessee Exports Facing E.U. Sanctions

	HS Number	E.U. Exports (\$)	% of Global Exports
Rolling Machine Cylinders	842091	59,955,465	68.66%
Oak	440791	16,975,574	70.20%
Toilet Paper	480300	7,632,349	16.91%
Safety Glass (non-auto)	700719	5,710,926	28.71%
Kraftliner	480411	4,916,132	36.12%
Taps and Cocks for Thermostats	848180	4,796,314	22.90%
Nonconiferous Lumber	440799	4,667,929	30.80%
Marine Engines	840810	4,110,899	81.06%
Antenna Parts for Radio and TV	852990	3,599,598	34.79%
Aluminum Wire <7mm	760519	3,560,361	89.77%
Printing Paper	481013	2,990,680	20.03%
Primary Cells and Batteries	850680	2,931,107	19.47%
Steel Wire	732620	2,410,696	59.11%
Mechanical Appliances	847989	2,329,869	22.89%
Machinery for Hot Drinks, Heating	841981	2,275,330	77.56%
Portable Electric Hand Tools	846729	2,156,903	36.68%

The pain would be felt across Tennessee. There are 25 different commodity sectors on the sanctions list exporting more than \$1 million in goods to Europe. But a handful of industries would bear most of the cost. The 16 industries shown in the table account for three-quarters of the state's sanctioned goods (\$131 million).

Why were these industries chosen? The E.U. chose commodity sectors for which FSCs were widely used. These are usually sectors populated by very large firms. The Tennessee paper industry, calendaring machine industry ("rolling machine cylinders"), and lumber industry are three local examples.

Using the rule of thumb that \$1 billion in exports supports 20,000 jobs, as many as 3,540 Tennessee jobs could be involved in this dispute. If these exports were lost, the direct economic impact on Tennessee would be in the range of \$310 million, and the total impact (including indirect exports and tertiary production) could reach \$700 million. Trade wars, like real wars, are not cheap.

Globalization brings great opportunities and dangers. As trade becomes more important, the skillful political management of the issues involved becomes more important as well. The WTO will be the fulcrum of these politics. As we can see, the Tennessee economy will be greatly affected by what happens there. ■