

Global Commerce

Tennessee and the International Economy

The Explosion of Free Trade Agreements

by Steven G. Livingston

America is turning to regional free trade agreements (FTAs), and in a big way. In the past year, the United States has ratified two such agreements, completed another three, and is in negotiations on yet three more. If that isn't enough, the U.S. has proposed a free trade agreement with the entire Middle East and continues to push the Free Trade Agreement of the Americas initiated by President Clinton. Why is this happening, and how will it affect the economy of this state?

To begin with the basics, a free trade agreement is exactly that. It is a treaty that mandates the end of most, if not all, barriers to trade between signatory countries. To date, America's free trade agreements have generally mandated that both parties drop all tariffs on manufactured goods and many agricultural products and remove obstacles to trade in services. This complete market opening is usually staggered over a period of years. El Salvador, for example, will end its restrictions on U.S. imports over a period of 18 years as part of the CAFTA (Central American Free Trade Agreement) treaty. However, it is usually also the case that a few of the most sensitive sectors will remain protected. For example, the U.S. sugar market will not be fully opened to Australian competition under the terms of that FTA, nor will the American textile and apparel industry be completely opened under the CAFTA.

The U.S. signed its first free trade agreement with Israel in 1985. This was followed, of course, by NAFTA in 1994. At the end of 2001, a third treaty was signed with Jordan. Then came the FTA explosion of the past two years. (See the list in Table 1.) Once upon a time, the U.S. was skeptical of regional FTAs because they were thought to detract from the larger long-range goal of *global* free trade. This view has obviously changed. Explanations for the increased focus on FTAs

Table 1. FTAs: Completed and In Negotiation

	Year	% U.S. Exports	% TN Exports	Leading TN Export
Australia	Signed – Feb.	1.80%	1.78%	Mowers
Bahrain	In Progress	0.07%	0.02%	Whiskey
CAFTA*	Signed – Feb.	1.53%	1.44%	Men's/Boys' Shirts
Chile	2003	0.37%	0.04%	Cotton
Israel	1985	0.95%	0.25%	Chemicals
Jordan	2001	0.07%	0.03%	Artificial Filament Tow
Morocco	Signed – March	0.07%	0.02%	Construction Equip. Parts
NAFTA	1994	36.88%	45.12%	Motor Vehicle Parts
SACU**	Initiated	0.40%	0.37%	Whiskey
Singapore	2003	2.29%	1.74%	Airplane Parts
Thailand	Initiated	0.80%	0.67%	Cotton

* CAFTA = Central American Free Trade Agreement; ** = South African Customs Union

vary, but it appears that the U.S. has adopted a new trade strategy of moving as fast as possible toward free trade with those nations that are also interested in doing so. To some extent, this may be seen as a counter to the current difficulties in the global WTO negotiations and to the increasing domestic controversy that surrounds free trade.

Assessing the economic impact of these agreements is somewhat difficult, for most are very new. There is little doubt that NAFTA has had a significant impact on trade and investment flows across North America. But this seems a special case, given the common borders of the NAFTA partners and the rather sizable level of economic interactions that existed even before the treaty was signed. The U.S. notes that the Jordanian FTA has dramatically expanded trade with that country, but Jordan is a very small market and it would be dangerous to draw too many lessons from it. In fact, most of the FTAs are with much smaller trade partners. Table 1 shows that, NAFTA excepted, no FTA involves more than two percent of U.S. trade, and they do not combine to much more than eight percent of total U.S. trade. (Although to be fair, eight percent of U.S. trade

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FTAs

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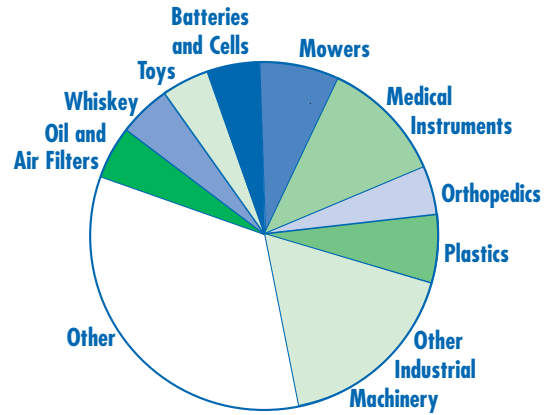
About 21 percent of all Tennessee exports go to the E.U., roughly the same proportion as for the rest of the U.S.

amounted to \$55 billion in 2003.) The two largest of the new FTAs, those with Australia and with Singapore, involve countries that already had relatively low trade barriers to U.S. goods.

What this means is that Tennesseans should probably expect to see only modest trade gains from these treaties. Thus far, each FTA has involved a lower percentage of Tennessee exports than the national average. Combined state exports to the non-NAFTA FTA partners amounted to about \$800 million in 2003, not an insignificant amount but only 6.36 percent of state exports. Argentina and Singapore accounted for 55 percent of that trade. Much of the anticipated American gains from these FTAs will be in the service sector, and for the most part these are not firms located in this state. This does not mean that some individual sectors will not do very well as a result of these agreements. Tennessee is a substantial vegetable oil exporter, for example, and this product is one that might benefit significantly from the Chilean FTA. Industries that use mail order or deal directly with foreign consumers might also gain

A Diverse Market

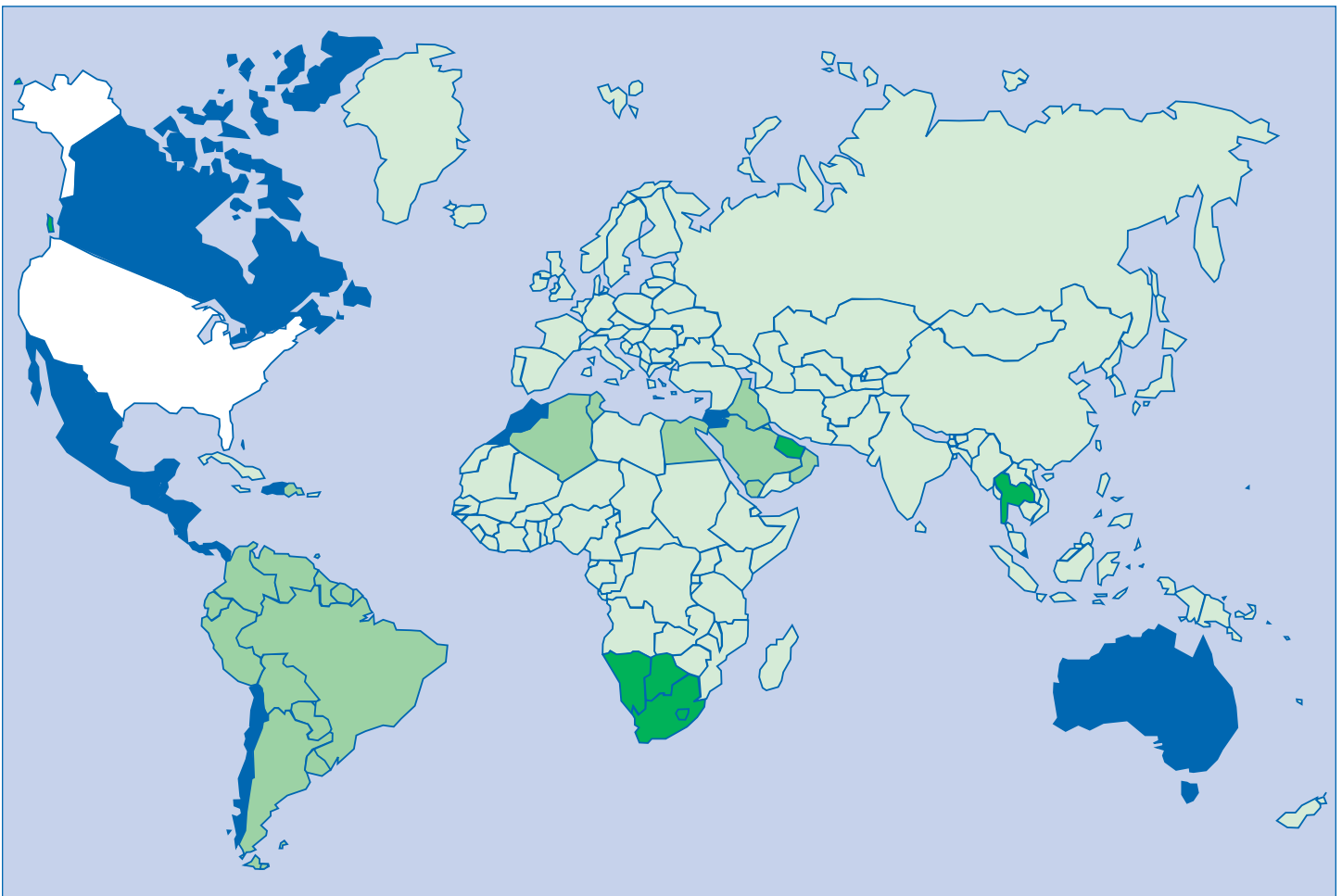
Tennessee Exports to Australia, 2003



from the reduction in trade barriers and customs regulations. But the state's major export industries either are not in these FTA markets or already have a large presence in these markets and will thus rely more on local growth than the particular

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An FTA Map of the World



4th Quarter 2003

Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$583,019,238	-2.5%	5.4%
Computer and Electronics	\$502,089,662	28.0%	4.2%
Chemicals	\$475,665,000	17.1%	19.8%
Agriculture	\$331,187,257	79.0%	29.3%
Industrial Machinery	\$308,496,404	7.4%	14.6%
Miscellaneous Manufactures	\$207,178,594	16.7%	39.0%

4th Quarter 2003

Passenger car exports rose sharply.

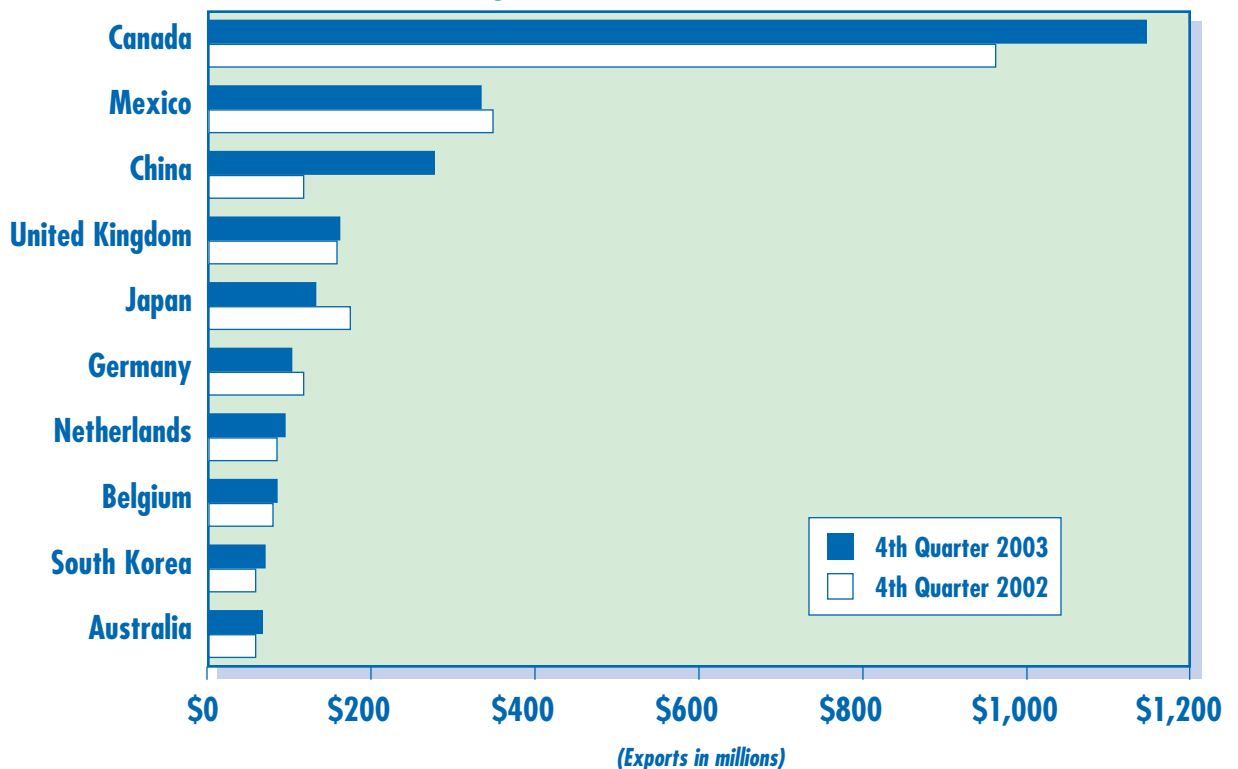
What's Hot and What's Not

(among Tennessee's top 100 exported goods)

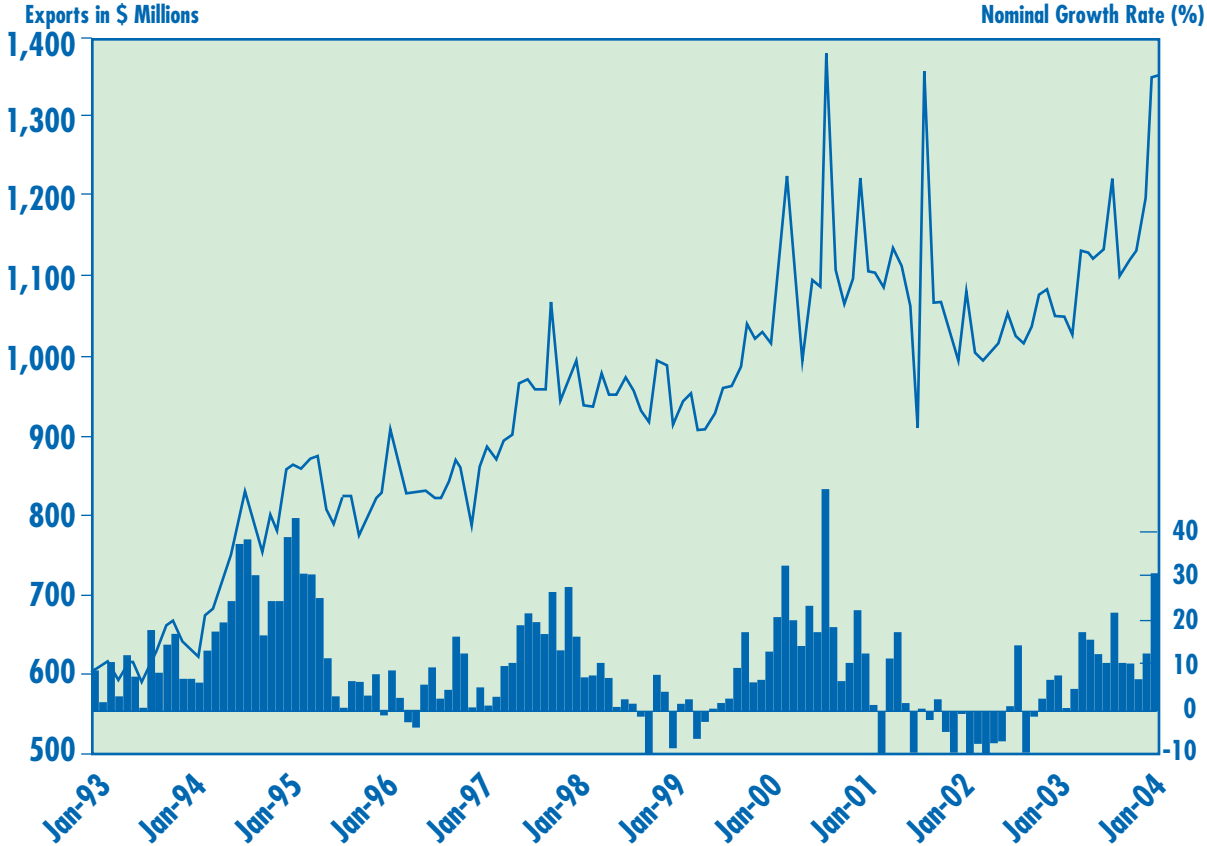
	Value of Exports	Growth	Decline
SECTORS WITH THE GREATEST GROWTH			
Cars (engine not specified)	\$9,072,090	17,031.0%	
Cars with Cylinder Capacity > 3000 CC	\$17,086,494	1,940.5%	
Gas Turbines > 5000 kw	\$22,500,000	1,022.2%	
Parts for Instruments that Measure Ionizing Radiation	\$19,654,806	680.4%	
X-Ray Control Panel/Treatment Parts	\$15,871,881	535.7%	
SECTORS WITH THE GREATEST DECLINE			
Medical X-Ray Apparatus	\$346,094		-94.6%
Electrical Circuitry Parts	\$3,761,242		-82.7%
Transmission/Reception Apparatus for Phones and Radios	\$7,126,159		-72.4%
Motor Vehicle Metal Mountings	\$1,935,998		-72.0%
Synthetic Yarn, Not for Sewing	\$3,150,691		-68.9%

China has become the state's third largest market.

Tennessee's Leading Trade Partners



Tennessee's Monthly Exports



(Seasonally adjusted, expressed in year 2000 dollars)

4th 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			
Russia	\$5,402,496	405.3%	
Pakistan	\$5,738,244	138.2%	
Philippines	\$29,963,611	134.4%	
Vietnam	\$3,379,678	128.6%	
Austria	\$5,660,214	101.5%	
COUNTRIES WITH THE GREATEST DECLINE			
Poland	\$935,263		-83.6%
Hungary	\$1,875,231		-76.5%
Ecuador	\$4,821,940		-37.6%
Norway	\$2,498,864		-37.0%
Guatemala	\$6,652,417		-32.4%

Tennessee International Trade Report

Tennessee exported a record \$3.355 billion in goods during the last quarter of 2003. This exceeded the state's previous best quarter by more than \$50 million and was a 12.5 percent gain from last year. Overall, 2003 turned out to be a good year for Tennessee exporters. Total annual exports stood at \$12.6 billion, a \$1 billion (8.5 percent) increase over 2002.

Exports were up in most of the state's major markets. The NAFTA market grew 13.5 percent (to \$1.486 billion). Sales to the Pacific Rim nations, now clearly Tennessee's second most important regional market, increased 25 percent (to \$822 million). And the E.U. purchased 6.5 percent (to \$658 million) more Tennessee goods than it did a year ago.

Within NAFTA, however, there were two different stories. Exports to Canada soared. Led by vastly increased purchases of computers and laptops, shipments to Canada grew by almost 20 percent (\$1.1486 billion). The rise of sales within the computer sector is nothing short of dramatic. Combined sales of computers and laptops to Canada grew from \$6 million in the fourth quarter of 2002 to \$105 million in the fourth quarter of 2003. Laser disc exports to Canada were equally impressive, doubling to \$63 million. Exports to Mexico, on the other hand, were flat. The story here was auto body parts, which fell by half (nearly \$40 million) from a year ago. Small gains in many other sectors were almost enough to offset this loss.

The Pacific Rim was the location of many of the state's strongest markets for the quarter. China was spectacular. Tennessee exports more than doubled (from \$119 million to \$278 million) in that market. However, this performance was mostly due to one product: cotton. South Korea and Taiwan also grew rapidly. In the case of Taiwan, this was due to a gas turbine sale, but in Korea the gains were across a number of sectors. The Philippines made sizable new purchases of Tennessee airplane parts and medical equipment, leading to a huge 131 percent increase in its imports from this state. Finally, sales to Australia grew 18 percent (\$67 million). The one very disappointing exception to the robust markets of the

Pacific Rim was Japan. Exports to Japan fell substantially (-23 percent, to \$134 million) as what was once the state's number two market fell to number five. A \$32 million drop in auto parts accounted for much of this loss.

Probably the best European growth was in Italy, where state exports gained 50 percent (to \$56 million). Medical instruments and diagnostic apparatuses formed the backbone of these gains. But most E.U. markets did rather well for the quarter. The two large exceptions were Germany and France, both of which purchased fewer Tennessee goods than a year ago. The losses in Germany were due to one product, electrical circuitry parts, while the drop in exports to France was more broad-based.

The worst performances in Europe were actually in the small markets of the central European nations, Poland and Hungary in particular. However, these numbers are exaggerated by the fact that several one-time purchases of goods, such as a large shipment of auto parts to Hungary in October 2002, were not repeated this year.

Thanks to strong cotton sales to Pakistan and tobacco sales to Sri Lanka, the state did well in the much smaller South Asian market. The Middle East, too, was up, though more modestly (from \$53 mil-

lion to \$61 million).

Only in the Americas did state exporters really struggle in the fourth quarter of 2003. Shipments to the Caribbean and to Central America saw no growth from a year ago, and sales to Latin America were down 10 percent (to \$145 million). The major problem was Brazil, where state exports dropped 21.6 percent (\$58 million). Cotton accounted for a little more than half of that loss, and car parts and pigment dyes accounted for most of the rest. Political and economic instability probably accounted for the poor performances in the small markets of Ecuador and Peru. The only bright spots in Latin America were Argentina and Colombia, each of which bought about \$5 million more in Tennessee goods than a year earlier.

Looking ahead, 2004 is off to a very good start. At \$1.111 billion, Tennessee's January exports were up a full 25 percent from a year ago. Half of this was due to cotton alone. ■

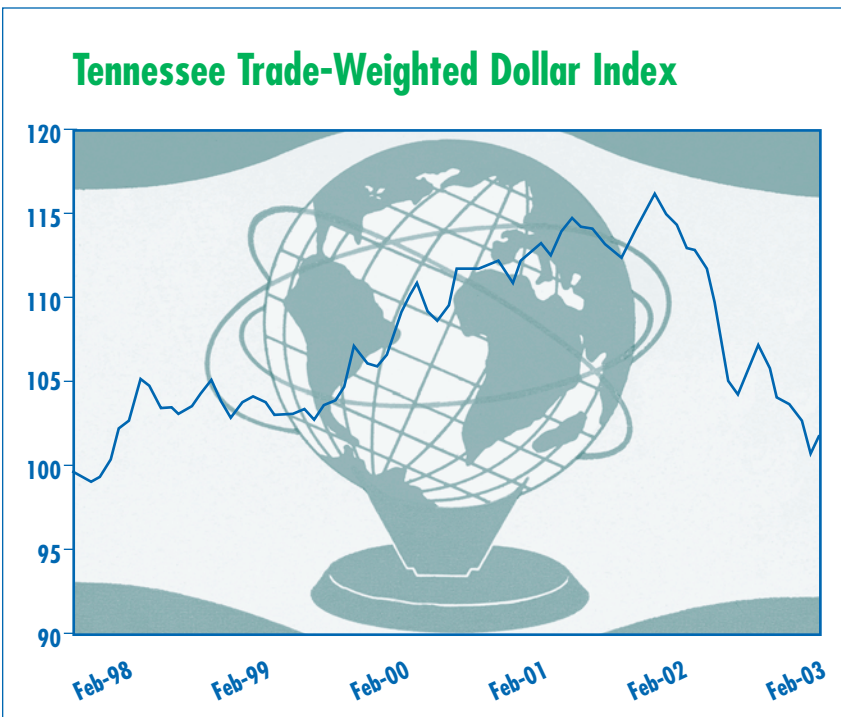
Exports were up in most of the state's major markets.



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FTAs

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benefits of the FTA. Similarly, it is difficult to find any particular sector of the state economy that will be greatly harmed by these agreements. The beleaguered apparel sector might be singled out, and it is partially protected in the CAFTA treaty, but the major competition and biggest threat for this industry is China and other Asian producers—not any of the FTA nations.

This somewhat tepid conclusion does overlook what might be the biggest gain for Tennessee. To the extent that FTAs are able to increase the growth of the total American economy, Tennessee, like every other state, will be a winner. This may turn out to outweigh the gains that we can identify as coming directly to Tennessee exporters.

It will be interesting to observe the success of these FTAs in coming years and to see which other countries will be brought into negotiations with the U.S. Whether the world will eventually come under one set of global trading rules, the WTO model, or will become a mosaic of free trade agreements among different nations will be one of the more significant trade issues in coming years. ■