

CAFTA-DR AND TENNESSEE

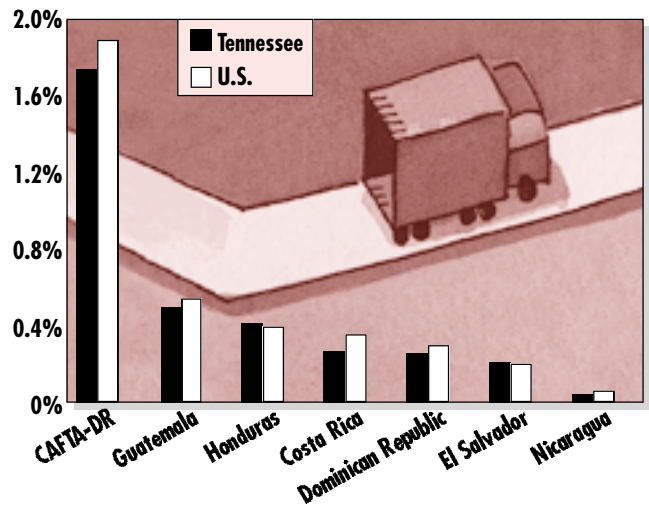
by Steven G. Livingston

On August 5, 2005, the CAFTA-DR became law. (CAFTA is the Central American Free Trade Agreement between the U.S., Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; DR is the Dominican Republic, which joined the CAFTA after it had been negotiated in 2004.) It wasn't easy. The vote in the House of Representatives was 217-215. Though the region is not a very large market, the CAFTA-DR became a symbol in the debate over globalization and free trade. Now that it is in force, what is its likely impact on Tennessee?

The CAFTA-DR eliminates most tariffs and drastically reduces nontariff barriers between these nations over 10 years. Some agricultural protections, though, will be kept in place for a good deal longer. For the U.S., the most notable exception is the sugar quota from its CAFTA-DR partners, which will be increased but only very modestly. Trade in services is similarly being opened. The most controversial aspect of the treaty is the promise of the Central American nations to bring their labor laws up to International Labor Organization standards. Some critics felt this was too low a benchmark or that it could be easily evaded.

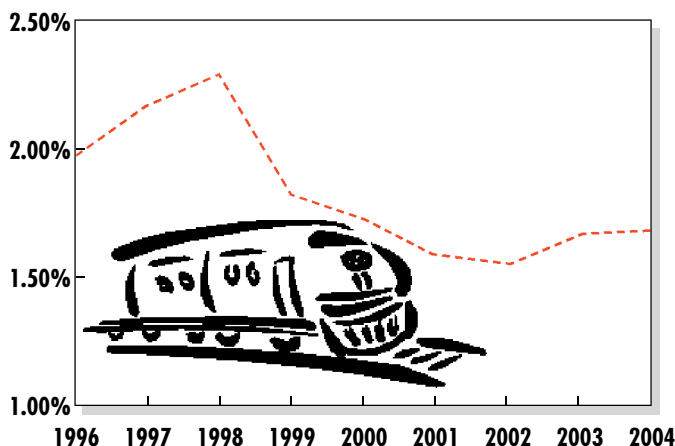
The CAFTA-DR market amounts to less than two percent of America's, or Tennessee's, exports. So it is substantially smaller than the NAFTA market, to which many have compared it. Though it has been growing rapidly over the

Exports to CAFTA-DR, Tennessee versus U.S.



past decade (Tennessee exports have increased 74.6 percent), it actually constitutes a smaller percentage of either state or national exports than it did 10 years ago. Nevertheless, the \$186.4 million in exports that Tennessee has sold the region in 2005 make it the state's 13th largest market, just ahead of France. The CAFTA-DR accounts for a similarly small share of America's imports. Thus far in 2005, it has sold the U.S. about \$17.7 billion in goods, only 1.2 percent of total American imports. Imports from the region, predominately apparel, have been growing at a far lower rate than those of the rest of the world.

Small and Getting Smaller?
CAFTA-DR as a % of Total Tennessee Exports



The Impact of CAFTA-DR: Imports

Because American tariff levels are already at or near zero for most CAFTA-DR manufactured products, the import effect on most manufactured goods is expected to be quite small. The big exception is the apparel sector, historically important to Tennessee. About half of U.S. imports from the CAFTA-DR nations are related to the apparel trade. The region has become integrated into American apparel production, taking American cloth and fibers and making them into clothing, which is then shipped back into the U.S. at various stages of completion. Some argue that the CAFTA-DR will save this Central American-U.S. supply chain and, with it, substantial American exports that would otherwise be lost.

The global apparel trade had been subject to special quotas since the early 1960s, a legal regime within which

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A Sample of Tennessee Firms Trading with CAFTA-DR

EXPORTERS TO CAFTA-DR	IMPORTERS FROM CAFTA-DR
Dupont	Martex Fiber
Altenburg Cotton	Cargill
Kolpak	Allen Accessories
Gideons International	Barnet Brass and Copper
Allen Machine	C & C Enterprises
Worth	American Uniform
AFG Industries	Triangle Pacific
PICTSWEET	Inamco International
Premium Pumice	Pressman Gutman
National Textiles	Franke Contract Group

Source: Business Roundtable

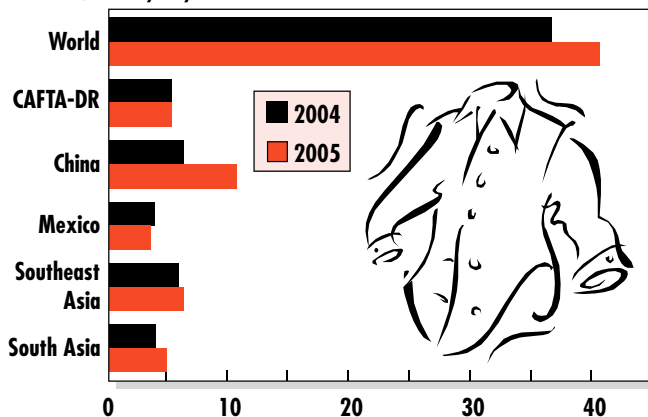
CAFTA-DR

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today's CAFTA-DR nations had preferred access to the American market. In 2005 this regime—and, with it, that preferential access—came to an end. With a now leveled playing field, the American market should be grabbed by the lowest cost producer. That producer is not the CAFTA-DR region; it is China and, behind it, the countries of South Asia. Many predict that the apparel industry of the Caribbean basin, absent CAFTA-DR, would be wiped out by this competition. The CAFTA-DR serves as a way to stave off this fate by providing the region with continued lower tariff and regulatory barriers than its global rivals. This would be important to the U.S., and to Tennessee, for two reasons. First, the apparel made in the region typically use American materials. Second, the earnings generated by the apparel trade enable the region to purchase substantial American exports. If the region's apparel production collapsed, American exporters of textiles and apparel materials would lose this market as production shifted to other countries that did not use American materials. Other American exporters would lose markets simply due to the eco-

American Apparel Imports

\$ billions, January-July

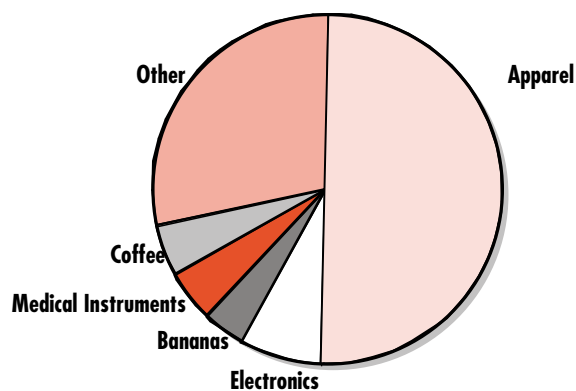


nomie effects of the region's loss of this important industry and its earnings. The National Association of Manufacturers (NAM) has estimated that this loss could be as much as \$4 billion per year.

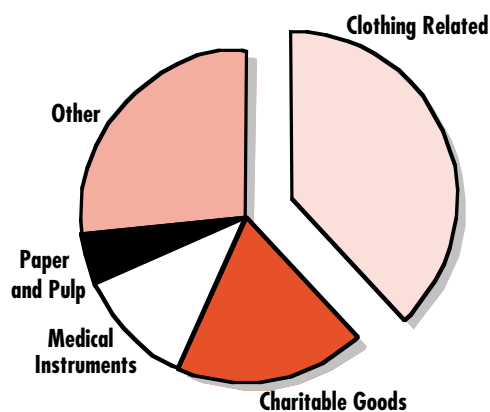
There are some caveats. First, China has been relentlessly gaining market share (as has South Asia to a lesser extent) for the past decade, even under the legal regime favoring Caribbean and Central American imports. During the past year, Chinese market share grew dramatically while CAFTA-DR nations' declined. It may very well be that, even with this agreement, the region's apparel industry will not survive. Second, in some cases, America would remain a major supplier of textile materials no matter where the industry locates. Tennessee, for example, is a huge supplier of cotton and manmade fibers to China and India. In this case, the monetary losses to the textile industry would be far less than predicted. Third, the NAM figures appear to presume that the region would not develop any alternative industry to replace its apparel losses. This does not seem likely. In stark terms, the most likely impact of CAFTA-DR *through imports* is that the agreement will slow the shift of apparel imports out of the region, leading

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U.S. Imports from CAFTA-DR, 2005 through July



State Exports to CAFTA-DR, 2005 through July



2nd Quarter 2005

THE STATE'S TOP MANUFACTURING SECTORS SAW DOUBLE-DIGIT GROWTH.



Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$1,087,432,267	29.4%	-0.4%
Computer and Electronic Products	\$609,372,542	22.5%	-9.6%
Chemicals	\$608,899,452	15.8%	8.9%
Miscellaneous Manufactured Goods	\$424,725,286	56.3%	16.1%
Agriculture	\$443,660,498	-13.8%	25.4%
Nonelectrical Machinery	\$398,600,217	8.4%	7.0%

2nd Quarter 2005

THE MEDICAL SECTOR WAS THE QUARTER'S STAR PERFORMER.



What's Hot and What's Not

	Value of Exports	Growth	Decline
SECTORS WITH THE GREATEST GROWTH			
Surgical Catgut	\$36,243,621	261,567.9%	
Pen and Pencil Parts	\$9,540,505	12,784.9%	
Peptones, Proteins, and Other Derivatives	\$18,452,033	291.9%	
Medical Needles, Catheters, and Parts	\$31,222,170	272.7%	
Transmission and Reception Apparatus	\$17,530,828	255.7%	
SECTORS WITH THE GREATEST DECLINE			
Yachts	\$10,087,172		-54.9%
Gas Turbines > 5000kw	\$15,060,737		-47.6%
Aircraft Parts	\$59,198,582		-46.8%
Line Telephony Apparatus	\$10,256,819		-45.4%
Laser Discs (not for music or images)	\$9,967,600		-44.7%

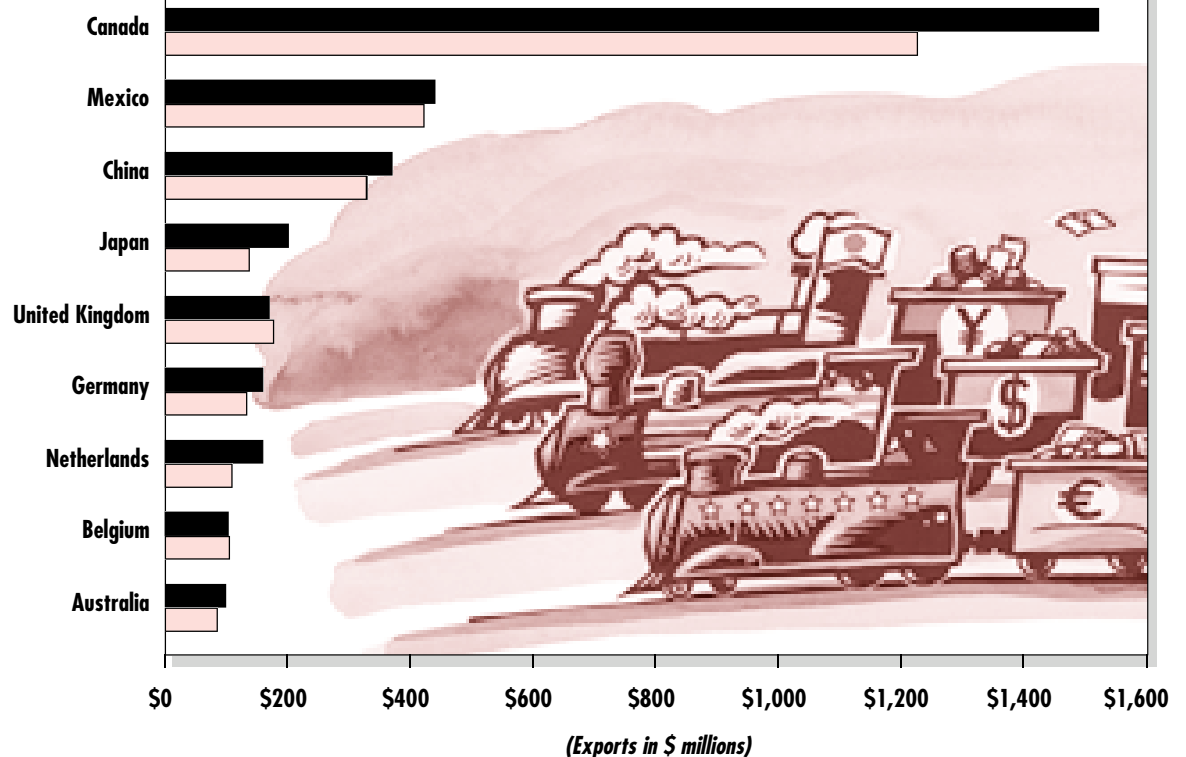
(Among Tennessee's top 100 exported goods)

■ 2nd Quarter 2005
 ■ 2nd Quarter 2004

THE CANADIAN MARKET WAS MORE THAN THREE TIMES THE SIZE OF ANY OTHER.

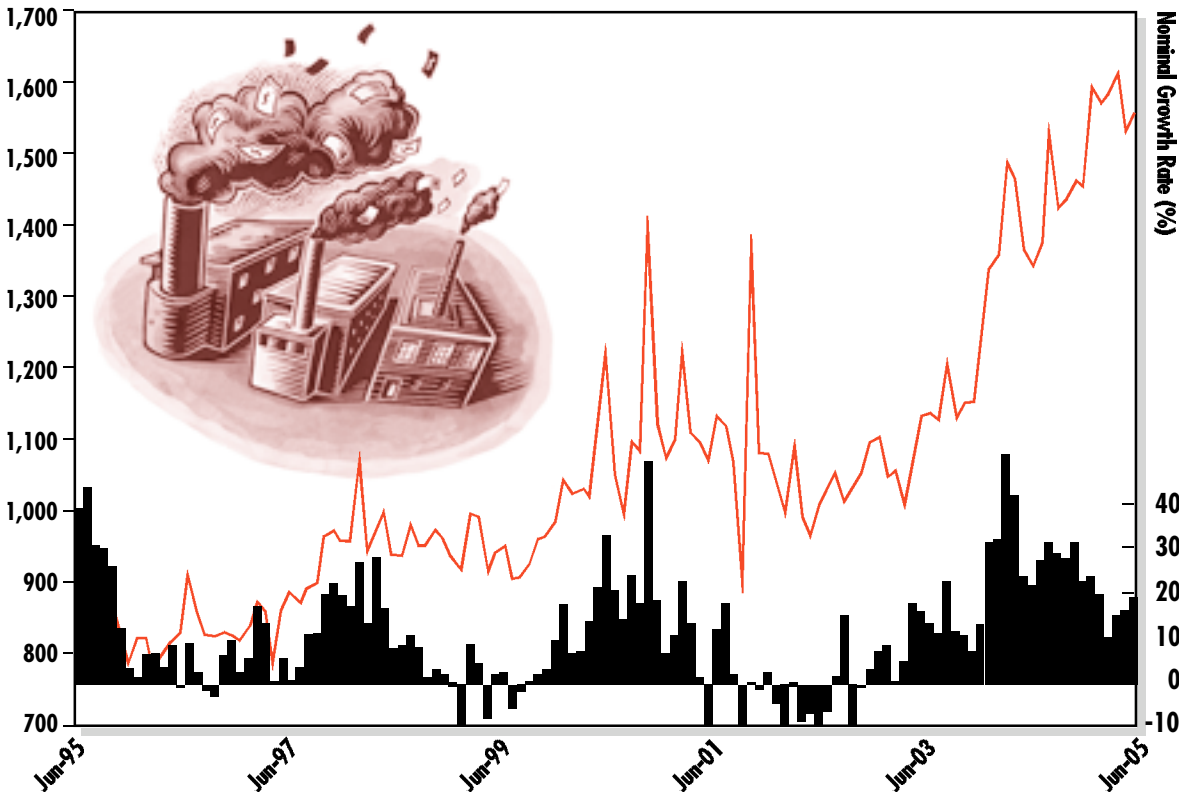


Tennessee's Leading Trade Partners



Tennessee Monthly Exports

Exports in \$ Millions



(Seasonally adjusted, expressed in year 2000 dollars)

2nd Quarter 2005

Fastest-Changing Export Destinations

	Value of Exports	Gain	Decline
COUNTRIES WITH THE GREATEST GROWTH			
Oman	\$13,879,340	3,891.4%	
Kuwait	\$50,322,137	1,046.2%	
Qatar	\$18,411,657	1,030.9%	
United Arab Emirates	\$70,174,824	499.1%	
Saudi Arabia	\$75,196,673	136.0%	
COUNTRIES WITH THE GREATEST DECLINE			
Singapore	\$55,982,885		-59.6%
Greece	\$7,954,412		-30.7%
Philippines	\$24,531,844		-30.6%
Switzerland	\$20,755,417		-28.6%
Turkey	\$56,763,021		-20.5%

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

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**MIDDLE
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THE SECOND QUARTER CONTINUED A STRONG TWO-YEAR RUN IN STATE EXPORT PERFORMANCE.

Tennessee exported a record \$4.73 billion in goods in the second quarter, a gain of more than \$700 million from a year earlier. About half of the growth was in Canada, but the state's foreign sales were strong almost everywhere.

The continuing tremendous growth in car and SUV exports formed the basis of the strong showing. Passenger vehicle exports almost tripled in the past year from \$153 to \$442 million. Almost half of new sales went to Canada, but the most spectacular performance of the quarter was a huge increase in vehicle exports to the Gulf States. Oman, Kuwait, Qatar, the United Arab Emirates, and Saudi Arabia combined to buy \$126 million worth of SUVs and cars during the second quarter, compared to SUV purchases of just \$1 million and no car exports a year earlier. Four of Tennessee's five fastest-growing markets were in the Persian Gulf region.

Much of the state's export growth, not just automotive, was to Canada. A wide array of Tennessee products significantly expanded sales there: laptop and desktop computer exports grew from \$97 to \$128 million; lawn-mower and road tractor sales both expanded by more than \$10 million. Only a few products saw export declines, most notably automotive seats (off \$10 million), laser discs (off \$9 million), and telephony equipment (off \$8 million).

Among the state's other large markets, Japan turned in the best numbers with exports up 44 percent (\$141 to \$203 million), the largest rise in some time. Gains were spread broadly, but a large contributor was the medical equipment industry. Electrodiagnostic units, surgical catgut, and medical needles combined for gains of \$27 million.

The steady rise of medical exports is one of Tennessee's major export stories over the past two years. Surgical catgut was the single fastest-growing export for the quarter. Markets as disparate as India and South Korea substantially increased their purchases of Tennessee medical goods. Globally, orthopedic appliance and parts

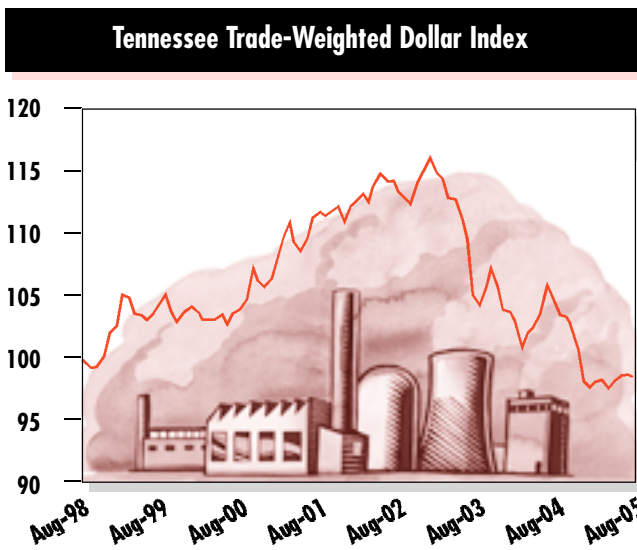
exports grew from \$43 to \$67.5 million, needle and catheter sales from \$8 to \$31 million, and X-ray gear from \$21 to \$31 million. Medical exports were the main reason for the state's strong showing in Europe for the quarter. Sales of medical instruments, now the largest exported good to the E.U. from the state, were up \$31 million in the E.U. (to \$105 million, mostly to Spain and France). Orthopedic sales were up \$10 million, and medical needle sales gained \$14 million, both to the Netherlands. That other Tennessee "medicine," whiskey, was the only nonmedical product that could keep up with this kind of growth. Thanks to strong gains in Spain, France, and Italy, whiskey exports to the E.U. were up 26 percent to \$67 million.

Overall, the E.U. increased its Tennessee purchases by 16.2 percent in the quarter. Along with medical products and whiskey, motor vehicle parts and chemical pigments experienced solid growth. A few products, though, did have a tough quarter in Europe: exports of airplane parts were down \$24 million (to \$48 million); yacht sales sank to just \$3 million thanks to losses in Germany and Spain; and turbojet parts lost nearly \$8 million due to a large decline in the U.K.

The biggest export-dollar losses for the quarter were in cotton, falling from \$503 to \$432.5 million, mostly in Asia (although exports to Mexico fell by half to \$25 million). Traditionally, Tennessee's overall performance in the Asian markets has depended on cotton sales. The Philippines and Turkey were both down due to cotton. South Korea and Hong Kong, where cotton is not a major export, both had very good quarters. Sales were up 21 percent to Korea (\$97 million) and 14 percent to Hong Kong (\$88 million). China, the state's largest cotton market, was one of the few markets in which cotton sales did not go down. Increases in other products, such as artificial filaments, produced a healthy 15 percent gain in Tennessee exports. The tough headwind of cotton losses, combined with a very poor performance in Singapore, meant overall exports to Asia were flat for the quarter.

Cotton exports to Latin America fell also, but state exporters still posted a 14 percent gain (to \$282 million), in large part thanks to organic chemical sales in Argentina. Though cotton losses led to a \$2 million drop in exports to Brazil, by far the largest South American market, Argentina increased its total purchases by \$9 million. The best numbers were posted in Guatemala (up 92 percent), almost all due to increased shipments of food charities. It was a good quarter in Mexico, where Tennessee exports rose from \$424 to \$444 million even in the face of the loss of cotton sales. Most increases were in the automotive industry (\$10 million in motor vehicle parts, \$24 million in cars), but computers (up \$11 million), chemicals (esters were up \$9 million), and circuitry parts (up \$6 million) also sold well.

The second quarter continued a strong two-year run in state export performance. While the transportation sector has led the way, the medical, chemical, and computer industries have also done well. The most encouraging sign is the state's ability to survive a substantial roll-off in cotton exports to maintain its current growth spurt. ■



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 **CAFTA-DR**
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to a modest mitigation of expected Tennessee export losses in the textile sector as production moves to Asia. Few other economic sectors should feel any impact.

The Impact of CAFTA-DR: Exports

American exports should expect a real but modest increase because of CAFTA-DR and the zero-tariff market. The U.S. International Trade Commission (USITC) estimates that the treaty will lead to a tiny (0.16 percent) increase in exports—but this still equals nearly two billion dollars. The NAM estimates a \$1 billion gain in exports.

Tennessee’s exports to the CAFTA-DR are dominated by several products, the largest and fastest growing of which is a bit of an oddity: charitable foods and goods. Because these have value, they are counted as exports. In 2005, Tennessee shipped about \$35 million in charitable goods to the region (two-thirds to Guatemala), about a fifth of the state’s total CAFTA-DR exports. These presumably will be unaffected by the treaty. The largest single sector, however, is still that of textiles and apparel, accounting for 40 percent of state exports to CAFTA-DR. Exports of clothing have declined rapidly over the past decade, but textiles, fibers, and cotton remain strong. USITC projections suggest that Tennessee could gain

about \$20 million in textile products because of the treaty, assuming that Asian apparel exports will be significantly hampered by the treaty.

A second likely winner is the motor vehicle industry. Based on national projections, the state’s auto and auto parts manufacturers should see exports increase by \$4 to \$6 million. (To maintain perspective, Tennessee exports about \$2 billion a year of cars, trucks, and parts.) The state’s chemical and medical equipment industries could each see gains in the \$3 to \$5 million range. Tires, paper products, potato chips, and cooking oil make up the remainder of the winner’s circle. Each, however, will be lucky to increase sales by more than \$1 million or so. Though the increased American agricultural sales that made up much of the pro-CAFTA-DR case are predicted, those added sales are unlikely to come from Tennessee. A small increase in chicken exports is the best we can expect.

An educated guess is that the state stands to increase its global exports by around \$40 million because of the passage of the CAFTA-DR. A multimillion-dollar gain is nothing to sneeze at and will mean more jobs and income for Tennesseans. On the other hand, this amount equals about 0.25 percent of state exports, reinforcing the belief that the treaty was more a battle of symbolism than of major economic repercussions. It’s fair to conclude that the state will experience a small economic benefit from the CAFTA-DR but one most Tennesseans will generally not notice. ■