



IMPACT ANALYSIS

Issues Impacting Global Business

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Dear Friends:

Many fear the U.S. is losing its competitive edge in manufacturing, science and technology. While the U.S. continues to remain strong, numerous challenges exist. What does this mean for you? (p1-2).

Is the trade deficit to blame for slowing GDP growth or is it the least of our worries? Flawed assumptions lead to poor policies (p3).

Is stimulus spending fending off a catastrophe or having a serious unintended consequence? (p4).

Although rising, the "China price" will not skyrocket. Six factors will keep prices in check or have less impact than anticipated (p5).

Hiring good employees in China may be the biggest obstacle facing companies there. Read what one company does (p6-7).

I hope you find this issue informative and, as always, we welcome your comments.

Sincerely,

Tim J. Nowak
Executive Director
World Trade Center Saint Louis

Is America Losing Its Competitive Edge in Manufacturing, Science and Technology?

The answer: yes and no

By John Manzella

Surprising to many, the United States manufacturing sector is not being hollowed out. With the exception of the recent recession when all U.S. industries experienced poor economic growth, U.S. manufacturing has been breaking its own record, year after year, with respect to output, value-added, profits, returns on investment, exports, and imports, says Dan Ikenson, associate director of the Cato Institute's Center for Trade Policy Studies. "U.S. factories are the world's most prolific, accounting for 21.4 percent of global manufacturing value added in 2008; China accounted for 13.4 percent," he added.

Again, surprising to many, long-term reductions in the number of U.S. manufacturing jobs are primarily due to the introduction of new technologies that boost productivity. As a result, fewer workers can create more products in less time. This, however,

doesn't mean that major challenges don't exist. They do.

Based on a variety of factors, a 2010 Deloitte report identifies China as capturing a leadership position and recently taking the number one spot for manufacturing competitiveness, followed by India, South Korea, the U.S. and Brazil.

What does this mean? The answer is unclear. What is certain is this: the strength of the U.S. manufacturing sector is very important because its competitiveness is an essential component in our nation's long-term economic health. "A strong manufacturing sector boosts a country's intellectual capital and innovativeness, underwriting research and development, pushing the technical envelope, and driving the growth in demand for highly skilled workers and scientists," the Deloitte report concludes.

Consequently, it's important that



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government policies enhance—not hurt—the strength and competitiveness of American producers. Unfortunately, the majority of respondents in the Deloitte survey from China say their government makes competitiveness easy as compared to respondents from Europe and the U.S.

The Number One Driver

Based on surveys of more than 400 senior manufacturing executives worldwide, the Deloitte report concludes that the availability of talented people—scientists, researchers, engineers, production workers, and teachers—is first among several drivers of manufacturing innovation and has a major influence on manufacturing competitiveness. As a result, acquiring and developing the right talent is extremely important if companies, in the manufacturing sector or other industries, wish to be innovative and improve their level of global competitiveness in the future.

This has become a serious issue for the United States. Stated by Bill Gates in a recent U.S. Senate hearing on strengthening America, “the U.S. cannot maintain its economic leadership unless our workforce consists of people who have the knowledge and skills needed to drive innovation.”

Gates further said the U.S. has one of the lowest high school graduation rates in the industrialized world. Therefore, America needs to transform its high schools, encourage the best foreign students to enroll in U.S. universities and live here well after graduation, and, to a higher degree, invest in research and reward innovation, he continued.

U.S. Science and Technology

According to a 2008 report by the Rand Corporation, a nonprofit global policy think tank, America continues to lead the world in science and technology, an essential factor in productivity. In 2009, the U.S. also was ranked first in innovation and global competition by the World Economic Forum, a Geneva-based non-profit

foundation best known for its annual meeting in Davos, Switzerland.

This makes sense. The U.S. accounts for 40 percent of total world research and development (R&D) spending, and 38 percent of patented new technology inventions among members of the Organization for Economic Cooperation and Development (OECD), an international organization of the industrialized, market-economy countries. Plus, the U.S. employs 70 percent of the world’s Nobel Prize winners and 37 percent of OECD researchers, and is home to 75 percent of the world’s top 40 universities, the Rand Corporation says.

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recognized nations, including China and South Korea, that are achieving rapid growth in R&D expenditures. It also noted that the European Union’s original 15 members and China are graduating more scientists and engineers than the United States.

The Rand report also concluded that offshoring of high-skill work, which is increasingly driven by the need to access scarce talent, does not result in job losses in the originating country. Plus, it said the U.S. will benefit even if significant new technologies are invented elsewhere, as long as it maintains the capability to acquire and implement them.

Many critics of the Rand study question whether or not the U.S. is adopting the right policies to maintain its lead. The Information Technology and Innovation Foundation, a research and educational institute

based in Washington, D.C., points out that rapidly growing and increasingly sophisticated Asian competitors and European countries are implementing concerted national science, technology and innovation strategies that could challenge the United States. Plus, it says many American advantages are eroding, and in several cases, vanishing. On innovation and competitiveness, the Information Technology and Innovation Foundation placed the United States sixth among 40 countries and regions based on 16 indicators.

It’s All Global

According to a 2009 Brookings Institution study, “The first decade of the 21st century has been one of global economic transformation to a degree that Washington has yet to grasp.” As such, U.S. policies have

not kept up with today’s realities: global economic integration is becoming more dynamic as the global balance of economic influence shifts to the Asian-Pacific region.

Today, globalization has an impact on virtually every business. In turn, international markets, customers and talent pools are becoming central to the growth plans of many, if not most companies. Combining this expansion strategy with cutting edge technology and innovation driven by talented employees will be key to U.S. corporate and global competitiveness in the years ahead. ■

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Is the Trade Deficit To Blame for Slowing GDP Growth?

Current statistics don't reflect what is actually occurring

By Daniel Griswold

What had been a recurring story line buried in the business section has now burst onto the front page: “Economic growth slowed by trade gap,” the *Washington Post* reports. This headline sets the stage for a story long on generalizations: “A widening U.S. trade deficit has become a substantial drag on economic growth as the country’s exports struggle to keep pace with the swelling sums that Americans are again spending on imported goods.”

The half truth: exports fell by \$2 billion in June compared to the month before, and this has a negative effect on overall GDP growth. But in our more globalized world, the rising wealth of our trading partners translates into more production in our own economy, and vice versa.

The fatal flaw in the story line is the assumption that rising imports slow economic growth. This rests on a simplistic Keynesian view that if a portion of domestic demand is satisfied by spending on imports, then less demand exists for domestically produced goods, reducing output and employment.

This view neglects the supply-side role of imports. More than half of what we import consists of goods consumed by producers—capital machinery, raw materials, parts and other intermediate inputs. This helps us produce more—not less. The Keynesian view also confuses cause and effect: imports usually grow in response to *rising* domestic demand. Consumers more eager to spend “swelling sums” on imports typically buy more domestically produced goods as well.

The bean counters at the Commerce Department “subtract” imports from GDP not because those imports are a drag on growth, but to

avoid double counting. If we want to count the number of widgets and other goods added to the economy in a quarter, we would obviously not count those that have been imported. But this does not mean the economy would have been that much larger if the widgets had not been imported.

The *Post* story adds to the misunderstanding by claiming, “At a basic level, trade deficits represent a loss of wealth for a country—money flowing abroad for goods and services produced elsewhere, supporting businesses and workers in other countries.”

This betrays a basic misunderstanding of wealth that Adam Smith exposed two centuries ago in *The Wealth of Nations*. Does wealth consist

they are buying our assets: real estate, stocks, Treasury bonds, and so on. The “loss of wealth” supposedly represented by the trade deficit is almost exactly offset every year by a “gain of wealth” represented by the net inflow of dollars in the form of capital investment from the rest of the world.

Besides being wrong in its basic economics, making the trade deficit the scapegoat for slow growth poses a double danger for economic policy.

Danger number one: it tempts politicians to reach for the snake oil of protectionism to create jobs. If only we could stop the flood of imported goods, the flawed logic goes, Americans would make more of those same goods themselves, creating millions of jobs. In reality, higher trade barriers

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of money—pieces of green paper, blips on a computer, or in Smith’s day, bars of gold—or does it consist of the actual stuff that people produce to make their lives better: all those goods and services we consume each year? Smith argued it was the latter. And in that case, a trade deficit at a basic level represents an inflow of wealth from the rest of the world—a cornucopia of cool stuff arriving every day at our ports that stocks our retail shelves.

Of course, even if you think that dollars are the ultimate measure of wealth, obsession with the trade deficit ignores the fact that those dollars spent on imports quickly return to the United States. If they are not used to buy our goods and services,

impose a host of offsetting costs on the economy, resulting in lower output.

Danger number two: blaming the trade deficit diverts attention from policies that are far more plausible culprits in dampening growth.

Politicians find it much easier to blame imported consumer goods from China for slower GDP growth than huge looming tax increases, expensive new health care mandates, a depressed housing sector, and a generally anti-business climate in Washington.

The trade gap should be the least of our worries. ■

Daniel Griswold is the director of the Cato Institute’s Center for Trade Policy Studies.

Is Stimulus Spending Sending the Wrong Message?

We should spend more time on a plan to attack the real structural problems

By Larry Davidson

As I write this commentary, the Dow Jones Industrial Average is down. But this isn't really about the stock market; it's about three recent news items.

First, a special session that prevented our nation's leaders from their August recess added another \$26 billion to government spending. Second, the Federal Reserve formally announced its decision to downgrade its forecasts of coming U.S. economic growth and agreed to a small amount of further monetary stimulus (called QE or quantitative easing), and implied that more might be needed. Third, Laurence Kotlikoff, Boston University professor of Economics and a former member of the President's Council of Economic Advisors, said the U.S. is financially bankrupt and clearly argued against further fiscal stimulus spending.

The first two items are evidence that the dominant policy opinion is seemingly humane: more stimulus. Public Enemy #1 is slow growth that is too weak to boost employment. It appears we are in a vicious cycle—low employment means low spending which means low employment. Monetary or fiscal stimulus aims to increase spending. But is this really humane? On the surface it appears so. Putting school teachers back to work not only improves education, but it puts more money in the economy.

But what if most people see the stimulus for what it really is: a drastic and panicky attempt to revive an economy with multiple fundamental problems—none of which is too little government spending or money growth. What if school teachers and everyone else see these actions as a sure sign that things will get worse before they get better?

My guess is that most of the

stimulus recipients will save their newfound incomes, pay off their horrible credit card debts or abandon house payments. This does not sound so humane to me. It insures that the downspin will continue!

We know this because most experts agree that the lack of spending right now is a result of negative expectations and uncertainty. These last ditch fire hoses do nothing but inflame uncertainty. Shame on you Fed. Shame on you Congress! Humane indeed!

My Keynesian friend says there is plenty of evidence of past stimulus policies working. And I would agree that there have been times and places when some stimulus was necessary and did work. A couple of years ago,

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for example, some stimulus was useful. But even then I argued that too much stimulus would send the message that the "sky is falling."

Piling up even more stimulus today sends the wrong message. And it is scaring the crap out of everyone. Furthermore, if Kotlikoff is right, it sends a Grecian message as well. If more people believe that solving the U.S. financial gap will take Herculean increases in taxes and reductions in spending, they will translate this into even more pessimism. Are we giving a teacher a job today only to take it back tomorrow?

Clearly, I don't know the answer. But rather than play the populist



game of more stimulus, we should spend more time on a plan to attack the real structural problems (i.e. the things that caused the recession like decades of too little saving and too much spending). And we don't have to actually implement the policies today; we could agree on a set of real changes and a schedule that makes sense. This would give people confidence in the future. Why wait until

after the fall elections?

It is frustrating that the solution is right in front of our faces, yet we dodge it only to flail around with policies that worsen the situation. And the right policies will demonstrate we are smart enough to recognize the true source of our economic problems and tough enough to enact the right strategies. This will install the confidence and optimism necessary to encourage firms to boost production and hire more workers. ■

Larry Davidson is Professor Emeritus of Business Economics and Public Policy at the Indiana University Kelley School of Business in Bloomington, Indiana.

Why the “China Price” Will Not Skyrocket

Six factors that will keep costs in check or have less impact than anticipated

By Robert Heilman

Between July 2005-July 2008, the Chinese currency, the renminbi, also known as the yuan, appreciated 21 percent against the dollar. But due to a variety of factors, the price of Chinese goods exported to the United States only rose by single digits. Today, again, the Chinese currency is on the rise, but six factors are expected to keep Chinese prices from rising significantly or will have little upward impact.

Factor No. 1

Currency Appreciation: the Ying and the Yang

In recent years, in order to retain foreign marketshare, Chinese exporters absorbed much of their product price increases caused by the rise in the value of the renminbi. On the other hand, the higher valued currency allowed Chinese importers to get a better deal on global commodities and components. Combined, these factors had a neutralizing impact of the price of Chinese exports. This cycle is again likely to play out in a similar way.

Factor No. 2

Chinese Wages Unlikely to Rise Significantly, Even With Strikes

Highly publicized strikes in China, many of which have occurred at unpopular Japanese-owned firms, are unlikely to touch off a wave of additional wage strikes, experts say. Plus, wages are unlikely to rise as much as laws require.

Over the past several years, Chinese provincial laws have prescribed large increases in minimum wages. However, these often are ignored by factories that pay substantially lower rates and rarely recognize wage premiums for overtime. In efforts to

offset wage increases that do occur, many factory owners have moved their production facilities inland where wage requirements are lower.

Factor No. 3

Shipping Cost Increases To Have a Minimal Impact on Export Prices

Following the world financial crisis, container shipping rates plummeted. In fact, container rates as low as \$3,500 were realized in the first quarter of 2009. Since then prices have steadily escalated with peak shipping seasonal rates of \$6,000 now quoted. Overall, however, the price

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increase is unlikely to have an impact on typical shipments valued between \$50,000-100,000. Smaller shipments will have fewer units to absorb the shipping increases and therefore be affected to a greater degree.

Factor No. 4

Global Commodity Price Increases Will Affect Buyers Equally

Global commodity prices are anticipated to rise across the board, impacting buyers equally. For example, as oil prices vacillate, China's costs will rise and fall along with those in the United States. Consequently, most net importers of oil will be affected in a similar way.

Factor No. 5

Chinese Real Estate Increases Have



Less Impact on Commercial Buildings

Chinese real estate prices are, no doubt, driving up costs. But most of the real estate affected is residential, not commercial, according to several suppliers. In fact, due to the global slowdown, one supplier expects a

rent reduction for his showroom with a lease renewal after two years.

Factor No. 6

Excess Factory Capacity Exists

Chinese entrepreneurs have created thousands of new factories over the last several years. While the recent economic crash wiped out many, competition for U.S. and other foreign markets continues to heat up in China. In addition, Chinese entrepreneurs are constantly seeking to improve productivity and lower costs. These factors have helped keep a lid on price increases. ■

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Hiring the Best Chinese Candidates Requires a Sound Strategy

We prefer the “skills, motivations and commitment” interview method

By Anen Lee

For both domestic and foreign companies, hiring and retaining good employees in China is difficult. In fact, this may be the biggest hurdle facing most operations there. Adding to the challenge is the entry into the workforce of China’s “Generation Y” or “80 hou,” those born in the 1980s and raised in an era of relative affluence.

With the economy once again booming and labor market conditions relatively tight, 20-somethings with just a few years of work experience are in strong demand. What is the best way to attract and hire this new breed of Chinese employee?

Interview Methods Differ

Multinationals in China have developed unique tests and interview methods to identify good job candidates and retain them. A Japanese automaker, for example, uses a test to determine how applicants eat, favoring candidates who disregard instructions to eat slowly and bolt down their food. Those who eat more quickly are thought to have strong stomachs and digestive systems, and be in better health. Fast eaters, the theory goes, can complete work quickly and are more mentally acute.

A Taiwanese food maker employs a test that requires job applicants to clean toilets, observing whether potential hires are willing to tackle the task with zeal and sincerity. Those who balk at the request are eliminated. Why? The company prefers employees who recognize they must work hard and accept whatever is required.

Our firm, InterChina Consulting, uses the *Skills, Motivations and Commitment* (SMC) method to determine which applicants to hire after testing



and interviewing. While the various tests noted above are creative and have a purpose, InterChina believes the SMC test identifies the best talent.

A Case in Point

A leading European pharmaceutical group establishing a global R&D center in Shanghai sought InterChina’s help to fill a vital position. The job required both specialized exper-

standards, FDA and ICH guidelines, excellent English skills and international work experience. Finding a recruit possessing this mix of general and specialized skills plus experience was bound to be a challenge.

To attract the widest possible range of qualified candidates, we advertised the position on the Internet, sought referrals and searched databases. Despite the potentially

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tise in the area of generic drug R&D and overall plant management skills.

Since the first step to successful hiring is to accurately understand what the employer is seeking and to define the background and requirements of the position, for this client we determined the candidates should possess the following main attributes: generic drugs R&D experience, expertise in Active Pharmaceutical Ingredients manufacturing, proven plant management skills, a wide working knowledge of regulatory trends, GMP

large pool of qualified candidates, we initially failed to attract a strong response. Eventually, however, we managed to identify 10 potential candidates, though several problems emerged when we approached them.

In China, most of the general managers of pharmaceutical R&D centers are expatriates. Since this is a senior level position, most tend to be quite stable and loyal to their companies. Plus, most are satisfied with their remuneration and career opportunities, and are generally unwilling

to change jobs. In addition, about 90 percent of Chinese nationals working for Chinese companies in top management positions have sound experience in generic drug R&D and overall management skills. However, most do not have a good command of English or international work experience. This posed a problem.

InterChina found that Chinese returnees from overseas were the best candidates for the position due to their global experience and sound language skills. Plus, many were keen to return to China and, compared with expats or non-Chinese applicants, they remain highly motivated and committed to helping Chinese companies grow.

Considering the interests of the client and candidates, InterChina identified and interviewed potential candidates, utilizing an exhaustive but highly successful SMC process. And after a candidate was selected, InterChina also helped the candidate adapt to the client's corporate culture, rules, regulations and role in the company. Our SMC method proved useful in many other cases.

Background Checks

In China, people tend to exaggerate their backgrounds, abilities and experience. Fake university diplomas and other certificates are easily available. As a result, background checks are important steps in the selection process that should not be neglected.

In our process, we verify at least three referrals among a candidate's past three employers (we do not call on the current employer in order to ensure the candidate's confidentiality). In doing so, we explore the candidate's position, duration of employment, last month's salary, duties, and reason for leaving, as well as the seniority level of the immediate supervisor, those supervised, and whether or not the candidate was promoted or given a raise.

In addition, we ask referrals to

score each candidate on his or her knowledge of the previous position, performance, communications skills, organizational skills, attitude and conduct, relationship with others, and ability to work in teams.

Negotiating Salaries

On behalf of the client, InterChina also negotiates salaries. As such, we identify industry benchmarks for the position at hand and review salary reports from third parties such as Hewitt, as well as help determine the candidate's employment package, discover the candidate's expectations and evaluate whether they are realistic and consistent with industry levels. We also propose and gain client approval of a package, and reach an agreement with a candidate on the total package.

In one case, a North American auto parts maker was seeking a deputy managing director for its



Different Approaches Work

Noted above, there are various techniques one can use to identify and interview the best job candidate for one's company. Some use in-house HR departments or engage the services of an HR company or headhunter. Cisco, which is expanding its China staff by 60 percent, recruits 40 percent of its staff through headhunters. It also encourages internal staff to

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plant in Wuhan. After we completed our search and interview process, the client selected a candidate and made an offer. Since Wuhan was a new tier-2 city for us, we had little knowledge of local salary levels. As a result, we studied local benchmarks for similar positions. Apart from second hand research, we also reviewed data with the local HR association and found that salaries for top management positions in Wuhan, especially in the auto sector, were very close to those in large cities, like Shanghai and Beijing.

After gathering additional data, we proposed a budget for the position which the client approved.

recommend candidates and rewards them based on a successful hire.

The bottom line: creativity is key. In the hiring process, companies need to adopt a range of strategies while considering important guidelines as they hunt for the best talent available in China's challenging market. ■

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