IMPACT ANALYSIS

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Dear Friends:

Unemployment may remain high and economic growth slow for years to come. But there's a bright spot. Due to population trends, America stands to significantly benefit. Developing countries have even more to gain. To profit, follow the metrics (p1-2).

Free trade empowers the individual, limits the state, and helps American families balance their budgets. We don't need big government rigging markets to favor one producer at the expense of competition and the little guy (p3).

Chinese officials have been highly critical of the U.S. debt buildup and Washington's failure to resolve the debt crisis. But if China looks at its own policies, it will find serious problems that could ignite the next crisis (p4-5).

Three decades ago China was just emerging from a planned economy. Its retail sector was strictly regulated and commodities were scarce. That was then (p6).

I hope you find this issue informative and welcome your comments.

Sincerely,

Tim J. Nowak
Executive Director
World Trade Center Saint Louis

Today's Shifting Demographics Demand New Strategies

Follow the Metrics

By John Manzella

U.S. unemployment, at 9.1 percent in August, is likely to remain high for years. Economic growth projections continually seem to be revised downward. And the approval ratings for President Obama and Congress, which are at the lowest levels in memory, don't inspire confidence or encourage business investment.

Although there are many reasons for pessimism, there is a bright spot. The United States has a tremendous advantage over other developed countries due to its population growth projections and the impact on the economy. Emerging markets, recipients of virtually all non-U.S. population growth moving forward, stand to gain even more.

The Benefit of a Growing Population

From 2000 to 2011, the U.S. population grew by 10 percent reaching 312 million, according to the Census Bureau. And by 2020, this figure is projected to jump another 8 percent to 336 million. Immigration is partly responsible. Thus, in fiscal year 2009 alone, the United States issued more than 1.1 million permanent residence permits, 70 percent more than the next highest country destination.

By 2020, the populations of several developed nations, including Japan, Germany and Russia, will decline. And while the U.S. work force will grow over the next two decades, the European and Japanese labor forces are projected to shrink by 5 percent and 17 percent, respectively, says Robert Doll, Chief Equity Strategist at BlackRock Inc., the world's largest money manager. Why is this important?

Doll says the long-term growth rate of any economy is the change in the size of the work force multiplied by its productivity. Although Ameri-

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can productivity recently slowed, its overall performance is good. And this puts the United States ahead of many developed countries.

What about developing countries? According to Doll, so far the increase in their share of world growth has come mostly at the expense of Japan. The future may hold a different reality.

Look to Emerging Markets

In April 2012, world population is anticipated to reach 7 billion. And virtually all non-U.S. growth will occur in developing countries.

According to the Census Bureau, in 2011 the population of the less developed and more developed countries was 5.7 billion and 1.2 billion, respectively. By 2050, the numbers in less developed countries will swell to nearly 8.2 billion, yet remain under 1.3 billion in more developed ones. What's more, developing economies are projected to grow two to three times as quickly as the United States next year, the International Monetary Fund says.

In turn, emerging market demand is projected to rapidly rise while developed country demand falls. Thus, according to Credit Suisse, a financial services company, the American share of world consumption, at approximately 27 percent in 2010, is expected to decline to 21 percent by 2020.

During the same period, China's share of world consumption is estimated to climb from 10 percent to 21 percent. India's share is expected to double to 5.3 percent; Asia's overall share, with the exception of Japan, is predicted to rise from 17 percent to 32 percent.

Due to these and other global economic realities, many American corporations are forced to limit the numbers of employees they hire in the United States in favor of increasing employment abroad. Yet, even if the U.S. was growing considerably faster, its unemployment rate still would remain elevated. Why? The exponential increase in U.S. technology has enabled fewer American workers to produce more goods in less time. As a result, labor demand is impacted.

How important are foreign markets? Standard & Poor's analyst Howard Silverblatt says roughly half the sales and profits of S&P 500 companies are generated in foreign markets. Doll claims 70 percent of their incremental earnings growth will come from abroad. Although estimates differ, the percentage likely is much higher for many of the biggest U.S. corporations.

Reassess Your Global Strategy

When creating short and long-term global business and investment strategies, it's imperative to know where your target consumers will live. And as world population centers shift, companies must reassess which markets to pursue.

When creating global business strategies, it's imperative to know where your target consumers will live. And as world population centers shift, companies must reassess which markets to pursue.

For some, this may mean focusing on growing segments in the United States, a vast market that may temporarily be down, but certainly not out. In fact, the U.S. market has and will continue to achieve remarkable results.

For example, over the last decade, American gross domestic product (GDP) growth increased 18 percent in inflation-adjusted dollars. That is significant considering the bursting of the dot-com bubble in 2001 and the recent Great Recession, which continues to have a significant drag on the economy. American GDP also is 2.5 times greater than China's, the next largest economy.

In addition, Americans only represent 4.5 percent of global population, yet U.S. innovation delivers more than half the world's patents each year. Plus, the U.S. share of world value-added manufacturing is nearly 20 percent, United Nations statistics indicate. This market, which can't be ignored, will once again be a major engine of growth.

In the short term, however, and well into the future, exporters and investors should consider expanding in faster-growing developing countries. In order to succeed, it may be necessary to redesign or add new product lines or services to satisfy different tastes and needs. It also will be important to think outside the box in terms of market potential.

For example, average per capita incomes in developing countries are relatively low. In 2010, GDP per person was estimated by the United Nations at almost $4,500 in China, slightly more than $1,300 in India, approximately $10,600 in Brazil, and $47,000 in the United States. At first glance, U.S. producers are likely to assume that consumers in developing countries can't afford their products. This is a mistake.

India, for instance, has a middle class of approximately 200 million consumers with the same purchasing power as the United States' middle class. Compared to the entire U.S. population, many would agree that an additional market of 200 million consumers with substantial buying power is well worth pursuing. ■

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What Every Member of Congress Needs To Know

A Lesson in Economics, Global Trade and Why Protectionism Is a Fools Game

By Daniel Griswold

If I were a member of Congress and a constituent asked me at a town-hall meeting why I support free trade, here's what I would say in my policy-wonkish way:

Free trade empowers the individual and limits the state. The government should not be telling us where we can and can't spend our money. We don't need big government rigging markets to favor one producer over another at the expense of competition and the little guy.

Free trade helps American families balance their budgets. Import competition means lower prices, more choice, and better quality—for shoes, clothing, cars, computers and smartphones. Lower prices for consumer goods mean higher real wages for workers.

Protectionism is really a tax on the poor. Our highest remaining trade barriers unfairly tax products made and grown by poor people abroad and consumed disproportionately by poor families at home.

We still impose unconscionably high tariffs on imported food, clothing and shoes—the basics of a poor family's budget. The $26 billion we collect each year from duties on imports represent the federal government's most regressive tax. Free trade is a tax cut for the poor.

Trade is not about more jobs or fewer jobs; it's about better jobs. Trade only accounts for 3 percent of job displacement. Technology and internal competition displace far more workers. Just ask folks laid off from Borders, Blockbuster or Kodak (Bought any film lately?). Our high unemployment rate today has nothing to do with trade but with our "Made in the USA" housing bubble and failed stimulus.

Imports fuel American industry. More than half of what we import each year are not consumer goods, but the stuff businesses buy to produce their final products—raw materials, intermediate inputs and capital machinery.

Anti-dumping duties on steel and import quotas on sugar drive up costs for U.S. manufacturers, giving them one more reason to relocate their production offshore.

Exports are key to expanding U.S. output. Three-quarters of the world's spending power is outside the United States, and most of the world's growth is now in emerging markets. China is now the no. 3 market for U.S. exports and the no. 1 market for U.S. agricultural exports.

Free trade empowers the individual and limits the state. We don't need big government rigging markets to favor one producer over another at the expense of competition and the little guy.

Exports allow American companies to raise productivity through specialization and economies of scale. A quarter of a million small- and medium-sized U.S. companies are now selling abroad, accounting for almost a third of U.S. exports. Trade agreements, such as NAFTA and the pending agreements with South Korea, Colombia and Panama, give U.S. exporters the level playing field the politicians say they want.

Foreign investment in America is the flip side of the trade deficit. If foreigners don't use the dollars they earn selling in our market to buy U.S. exports, they buy U.S. assets: Treasury bonds, stock in U.S. companies, and direct investment in U.S. factories.

Today, more than 5 million Americans work for foreign-owned affiliates in the United States, earning 30 percent more than the average American worker. Companies such as Honda, Nissan, Toyota, BMW, Michelin and Severstal Steel employ one out of eight American manufacturing workers. Raising trade barriers will only make it harder for people in other countries to earn the dollars they need to buy our exports and invest in our economy.

Protectionism is a fool's game. The Smoot-Hawley tariff bill of 1930 didn't create or save jobs. Instead, it provoked retaliation against U.S. exports and only deepened the Great Depression. Republicans and Democrats worked together after the war to promote more open trade and peaceful commerce with our allies. It would be a huge mistake to turn our backs on such a successful bipartisan policy.

Free trade promotes liberty, prosperity, and peace. That's a good deal for America. ■

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China Must Liberalize

A Rule of Law Is Required that Assigns Responsibility to Individuals, Not the State

By James A. Dorn

Chinese officials have been highly critical of the U.S. debt buildup and the political wrangling in Washington that has failed to resolve the debt crisis. But China could well turn that leery eye inward to find policies that are preventing financial markets from functioning in a healthy manner—and which may yet spread the next serious malady to global financial markets.

One problem is that China is the largest holder of U.S. Treasury securities, with more than $1 trillion invested. Without China's large appetite for U.S. debt, Congress would have been more constrained in its deficit spending, and U.S. growth would have been more robust.

China now holds more than $3 trillion in official foreign exchange reserves, the result of large trade surpluses and inward foreign investment. However, China is a net exporter of capital via the purchase of Treasuries and other government securities. The large accumulation of dollars is the result of an exchange-rate policy designed to undervalue the yuan.

Which brings us to the second major problem: if the Chinese currency were allowed to freely float, there would be no massive buildup of official reserves. Traders, not communist party members, would determine the exchange rate. Adjustment would occur spontaneously via voluntary decisions, not via central plans.

A more flexible exchange rate and a fully convertible yuan would increase the range of choices open to the Chinese people, expand the private sector, and increase popular pressure for political reform.

The legacy of central planning still haunts the banking sector. Lending, interest rates, and the major banks themselves are all controlled by the state. Even more ominous is that most of the lending is to state-owned enterprises. Investment decisions are therefore heavily politicized, and corruption is rampant.

Stimulus spending allowed China to escape the 2008-2009 global financial crisis, but the rapid expansion of bank credit, as well as off-balance sheet lending, has led to excess money growth and an inflation rate of more than 6 percent. UBS data show that China's bank credit, including off-balance sheet loans, now stands at about 180 percent of GDP, up sharply from 2008.

China's rapid expansion of bank credit, as well as off-balance sheet lending, has led to excess money growth and an inflation rate exceeding 6 percent.

If the economy slows, non-performing loans could swell. The excess credit could turn into a debt crisis. That crisis could be compounded by a bursting of the Treasury bond bubble, once the Federal Reserve begins to increase interest rates, or once markets think the Fed will inflate and reduce the real debt burden.

China needs to tame domestic inflation and further liberalize its

economy. Yet, there is strong political pressure to continue to peg the yuan at an artificially low rate and "sterilize" the newly minted yuan—that is, drain off excess yuan by selling central bank bills, increasing reserve requirements, and setting tighter lending quotas.

Price controls and capital controls are also being used to suppress inflation and to limit private choices. But as long as China is trapped in its export-led development model, with financial repression, the hoard of foreign exchange reserves will grow and most of those reserves will be lent to the U.S government, not to private enterprise.

The challenge for both China and the U.S. is to restore the balance between the state and the market—to maximize freedom and minimize coercion.

The reality is that both China and the U.S. are growing the state sector at the expense of the private sector. Crony capitalism, not market liberalism, is now the norm.

For China to become a global financial center and achieve financial harmony, there must be privatization of the banking system, capital freedom, flexible exchange rates, market-based interest rates, and a rule of law that assigns responsibility to private individuals, not the state.

The mispricing of credit/risk and monetary manipulation plague both China and the U.S. Beijing is right to criticize U.S. policymakers for creating fiscal and monetary uncertainty. But what Beijing wants is more, not less government control, while the solution to the problem of creating economic and social harmony is less government.

With a rule of law and limited government, voluntary exchanges in private free markets would increase individual sovereignty and wealth, while promoting the general welfare. That concept of spontaneous order is now foreign to most politicians. Politics and "legal plunder" have trumped what the great French liberal Frederic Bastiat called the "law of liberty."

The challenge for both China and the U.S. is to restore the balance between the state and the market—to maximize freedom and minimize coercion. Rebalancing can then be market-directed, economic relations normalized, and politics put in its proper place. ■

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From a Seller's to a Buyer's Market

Dynamic Changes Are Occurring in China's Retail Sector

By James Sinclair

Looking back 30 years, China was only just emerging from a planned economy. Its retail sector was strictly regulated, commodities were scarce, and a ration system was still in place.

Coupons were issued not only for food and fuel, but also for bikes and televisions. Each coupon specified an item, quantity and sometimes a retail outlet as well. Meat in particular was in short supply, rationed at 0.25 kilogram per person per month, and many Chinese had to eat vegetarian diets. Regardless of financial wealth, without coupons Chinese people simply couldn't purchase goods.

Retail was dominated by state and collectively owned stores, and while a few free markets continued to exist in the countryside, they were considered 'the tail of capitalism' to be cut off sooner or later. The level of protection afforded to retailers, and lack of competition between them, resulted in poor performance and consumer service. No new retail formats or service innovations had been introduced for decades.

Due to the scarcity of products and the planned price system, it was the suppliers that really had the upper hand. Although they could not raise prices, they could choose whether or not to supply, and specify the volumes they would supply. It was not uncommon for retail buyers to use back door relationships to get hold of much wanted goods.

Reform and Opening

With policy relaxation over the past 30 years, the transformation of the retail sector has been dramatic. It began in the 1980s with the breaking of the stranglehold of the state and collectively owned stores, leading to an influx of individual retailers and reopening of free markets. Meanwhile, the government took steps to abolish the procurement and sales system, and reduce the number of consumer goods subject to planned prices.

Moving into the early 1990s, international retail chains began to enter China, bringing new concepts and management know-how. *Carrefour* was one of the first, entering during the year international participation in China's retail sector was granted. Since then, the number of foreign-owned retail stores has grown steadily.

China's WTO commitments, which gradually lifted the remaining restrictions on international retailers, attracted further newcomers from the mid-2000s onwards.

As the retail sector has grown, China has flipped from a seller's to a buyer's market. From having next to no choice, consumers are now spoiled by many choices, both in terms of what and where to buy.

China's retail sector will no longer be driven by deregulation, but by growth of consumption and competition between retailers, especially chains.

Retail Innovation

China's retail transformation still has a long way to go. It will no longer be driven by deregulation as in the past, but by growth of consumption and competition between retailers, especially organized retail chains.

Retailers now have to strive to better understand and satisfy consumer's needs. In turn, we are starting to see many of the world's best practices being adopted in China.

Nevertheless, the Chinese retail sector has not lost its distinct characteristics. In fact, in the near future, we expect to see cases of China leading the world in retail innovation. ■

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