



Global Commerce

Tennessee and the International Economy

TRADE WITH CANADA

A TENNESSEE UPDATE

by Steven G. Livingston

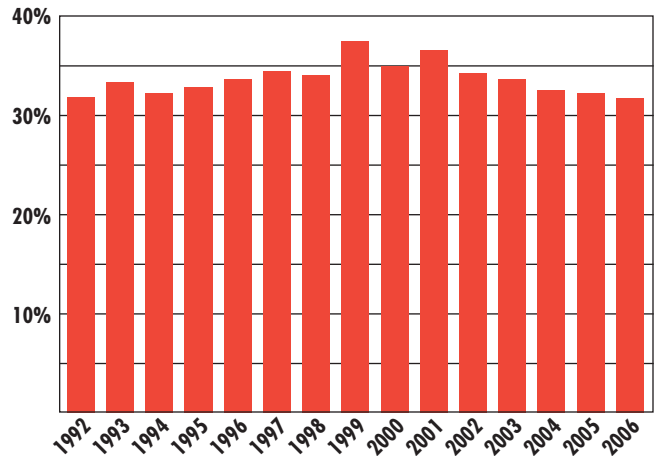
More than one-third of Tennessee's exports go to Canada. It has been 10 years since we last reported on Tennessee's trade with the nation that remains, by far, the largest foreign market for this state's goods and services. What has been happening north of border?

Big and Getting Bigger

Tennessee's exports to Canada have more than doubled in the past 10 years. State producers sold goods in Canada valued at \$6.925 billion in 2006, over \$4 billion more than sales to the state's second-largest market (Mexico). The remarkable feature of this market is that it just keeps growing. Though so much trade talk is about newly emerging markets around the world, export growth to Canada has kept pace with any other global region. Only China has substantially outstripped the Canadian market over the past decade. Indeed, Tennessee exports more intensively to Canada than do most other American states. As noted, about one-third of state exports go north of the border; this compares to about one-fifth of total American exports. As a result, Tennessee goods have increased their share of American exports to Canada by over 50 percent since 1997.

Imports from Canada virtually mirror the pattern of exports. Canadian imports to Tennessee have grown 185 percent during the past decade. Tennessee's imports from Canada are growing more than twice as rapidly than for the U.S. as a whole. As a result, Tennessee has climbed to become the 10th largest market for Canada among the American states. Tennessee has increased its share of all

Percent of Tennessee Exports Destined for Canada



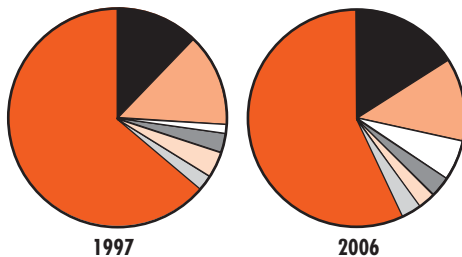
American purchases from Canada by the same 50 percent since 1997. Any way you look at it, trade between this state and Canada has been booming.

Though one might point to NAFTA as the explanation for some of this growth, a great deal of it can actually be accounted for more simply. Tennessee's two largest Canadian export sectors are the automotive sector and computers. Five of the top exported products at the four-digit HS (Harmonized Trade System) code level are in the automotive sector, and the sixth is computers. The former is, of course, the result of the earlier integration of automotive production across the U.S.-Canadian boundary. Nissan, GM, and many auto suppliers regularly ship production back and forth across the border. Nissan, too, ships its vehicles from Smyrna to Canadian auto dealers because it does not have a Canadian assembly plant. Much of the surge in computer exports to Canada is also the result of

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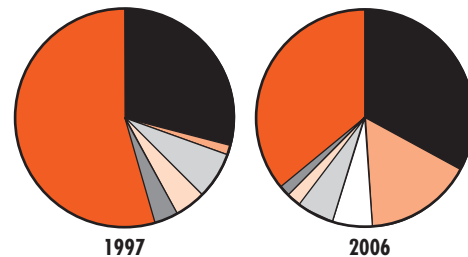
Exported Products

- Motor Vehicles
- Auto Parts
- Computers
- Seats
- Tires
- Tractors
- Other

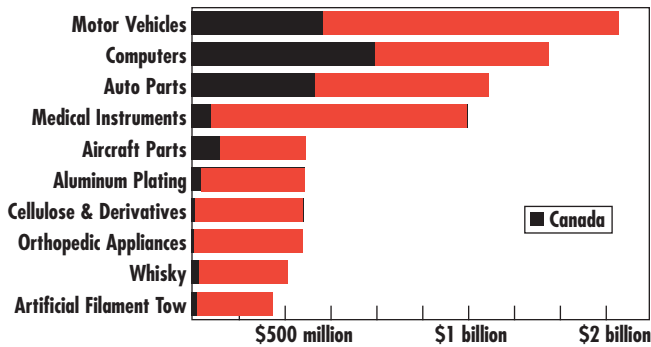


Imported Products

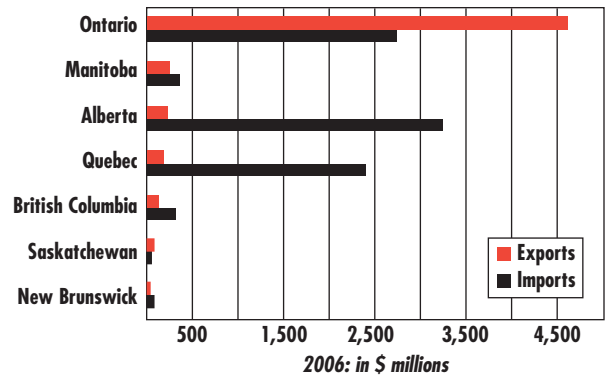
- Natural Gas
- Aluminum
- Medicaments
- Auto Parts
- Lumber
- Paper
- Other



Canadian Share of Top Tennessee Exports



Trade by Province



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the location of a major assembly plant, the Dell plant in Nashville. In turn, Canada's two largest export sectors to Tennessee are automotive products, again, and natural gas. The former is the flip side of the industry's cross-border integration, while the growth in the latter in large degree results from the big price increases that have occurred in the energy sector over recent years.

However, the size of these export sectors should not obscure the fact that the range, and value, of products traded between Tennessee and Canada is very deep. While we can see that automotive products (defined broadly to include tires, tractors, and seating) capture a good deal of the state's exports to Canada, and that they have increased their share of exports over the past 10 years, we can also see that more than half of Tennessee's Canadian sales are accounted for by other products. Twenty-four different exported products were valued at more than \$50 million in 2006. It is very difficult to find Tennessee products whose sales are not increasing in the Canadian market. Only a few—paper, glass, electric motors, carbon electrodes—have not been growing.

Canadian imports, though, have become a bit more concentrated in recent years. This in part is a price illusion due to the large increase in gas prices. These prices have increased the relative size of gas imports compared to other products. But aluminum imports have also grown dramatically. Only about \$4 million in 1997, Tennessee aluminum imports from Canada reached nearly \$1.5 billion last year. (These large imports have in turn fueled the state's large aluminum sheeting and plates sector, which has

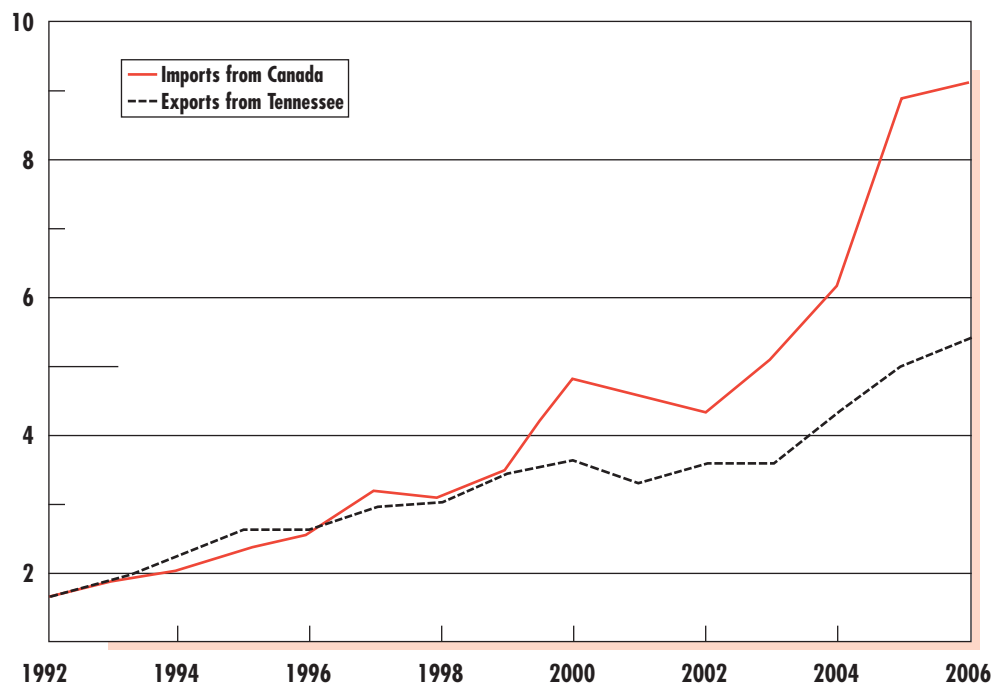
become one of Tennessee's major export industries.) Medicaments have also come out of nowhere to become a very large import from Canada. In 2006, Tennessee imported \$542 million in medicaments. Ten years ago there were no imports at all.

Going Provincial

Tennessee doesn't trade with all of Canada equally. The vast majority of its trade is with Ontario, Quebec, and Alberta. It trades virtually not at all with the maritime provinces. This trend has accelerated over the years. In part this is simply because the large majority of Canadians live in Ontario and Quebec. But it is mostly because the major industries with which Tennessee does business reside in these provinces. Ontario is the home of the Canadian auto industry. Quebec is the home of the Canadian aluminum industry. And Alberta is home to natural gas. Behind these three, Manitoba is the source of most of the

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Tennessee's Balance of Trade with Canada



1st Quarter 2007

IT WAS A TOUGH QUARTER FOR THE AUTOMOTIVE INDUSTRY.



Tennessee's Largest Export Sectors

	Exports	Change from Last Year	Change from Last Quarter
Transportation Equipment	\$1,129,307,994	-3.6%	-11.5%
Computer and Electronic Products	\$791,816,514	-1.7%	-5.5%
Chemicals	\$786,870,517	15.5%	6.5%
Miscellaneous Manufactured Goods	\$533,853,833	17.6%	-17.3%
Nonelectrical Machinery	\$438,966,787	5.0%	7.6%
Primary Metal Manufacturing	\$225,763,530	9.7%	-2.6%

1st Quarter 2007

Fastest-Changing Export Destinations

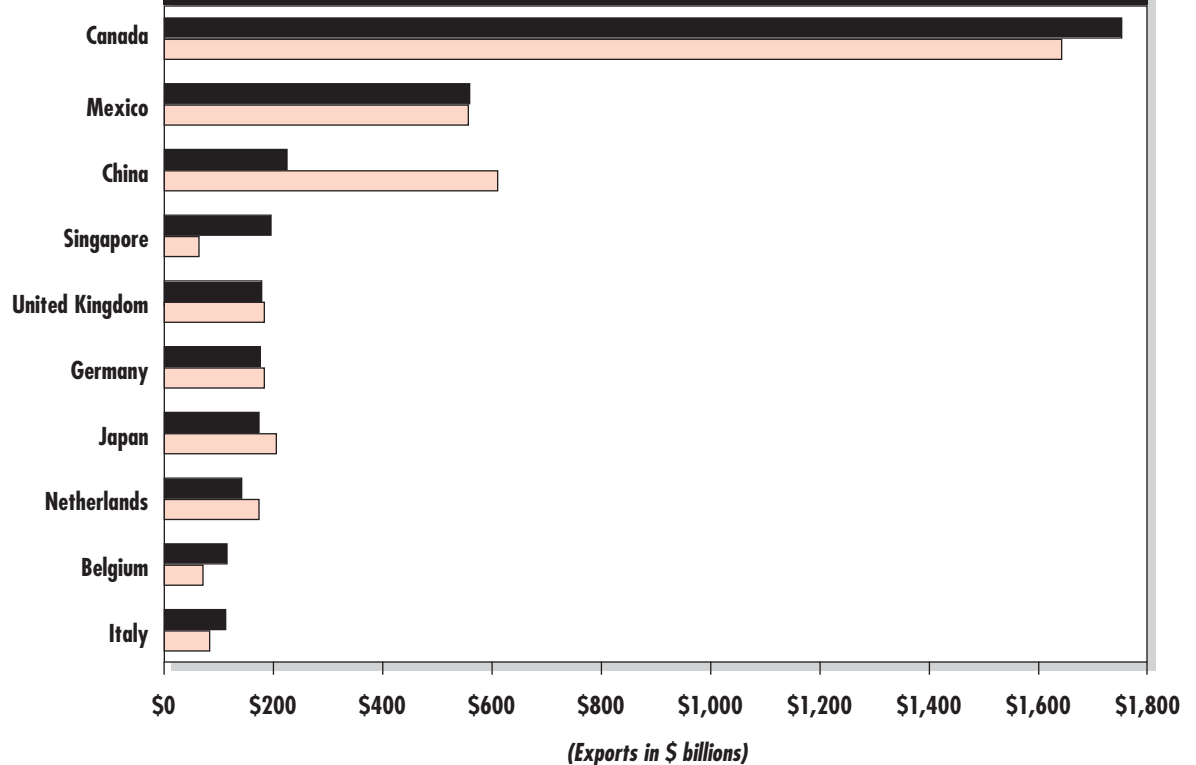
	Value of Exports	Gain	Decline
COUNTRIES WITH THE GREATEST GROWTH			
Jamaica	\$19,237,352	258.7%	
Singapore	\$209,203,010	203.1%	
Nicaragua	\$3,662,510	142.3%	
Tunisia	\$5,448,668	104.0%	
Switzerland	\$45,215,229	92.8%	
COUNTRIES WITH THE GREATEST DECLINE			
Jordan	\$838,801		-84.5%
Afghanistan	\$899,643		-68.1%
China	\$239,249,296		-61.5%
Oman	\$4,462,641		-56.6%
Turkey	\$22,316,900		-54.2%

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



■ 1st Quarter 2007
 ■ 1st Quarter 2006

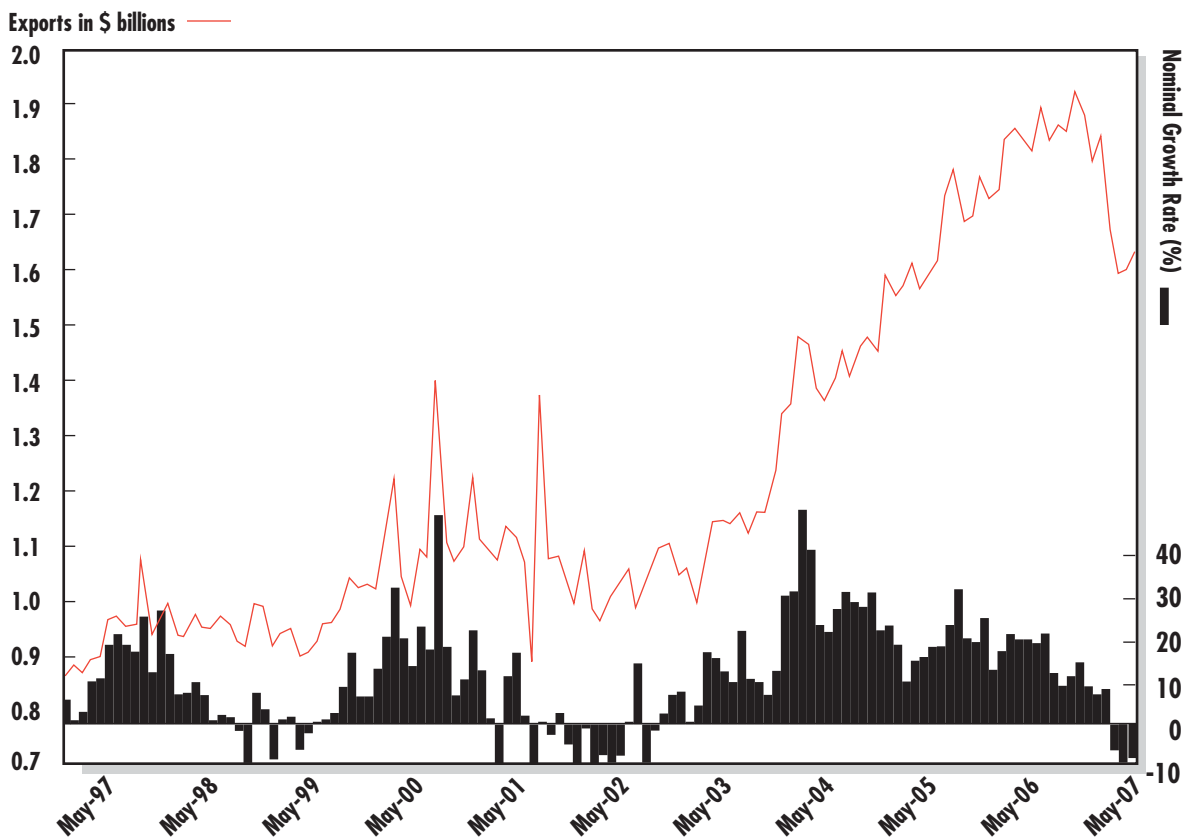
Tennessee's Leading Trade Partners



SINGAPORE WAS THE STATE'S STAR MARKET IN THE FIRST QUARTER.



Tennessee Monthly Exports



(Seasonally adjusted, expressed in year 2000 dollars)

1st Quarter 2007

Newly Classified Tennessee Export Products (in \$ millions)

	Export Value		Export Value
Optical Media	\$87.86	Safety Airbags	\$17.84
Computer Printers	\$41.81	TV Receivers	\$15.24
Motor Vehicle Brakes and Servo-Brakes	\$26.97	TV Parts for Transmission/Reception	\$14.89
Computer Monitors	\$22.39	Electronic Integrated Circuits	\$14.68
Voice, Image, and Data Recorders	\$20.92	Multifunction Printing/Copying Machines	\$8.43

THE U.S. REVISED ITS CUSTOMS CODES TO REFLECT THE DEVELOPMENT OF NEW PRODUCTS. HERE ARE SOME NEWLY CODED EXPORTS.

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THIS IS THE FIRST TIME IN FIVE YEARS THE STATE'S QUARTERLY FOREIGN SALES HAVE POSTED A DECLINE.

The first export numbers for 2007 are a bit worrisome for Tennessee exporters. Although, at \$5.226 billion, the first quarter of 2007 was the fifth best on record, the numbers were also 3.7 percent lower than a year ago. This is the first time in five years the state's quarterly foreign sales have posted a decline. What is happening?

The answer starts with cotton. Cotton exports were down 89 percent for the quarter. In the first quarter of 2006, cotton was the state's top export and accounted for more than 10 percent of all Tennessee exports. In the first quarter 2007, cotton fell to 18th among the state's exports at the six-digit HS-level, amounting to just over one percent of the state's total. This collapse began in mid-2006. For a while, robust growth in other export sectors was enough to offset its effects. But a loss of \$500 million, and such was the figure for this quarter, has proven too much. Other export sectors simply can't take up the slack. The drop in cotton exports has two facets. On one hand, American cotton exports are down generally. They fell by 35 percent this quarter. China and other key markets have substantially reduced their cotton imports. But 35 percent is, of course, far short of 89 percent: Tennessee sales have dropped off far more dramatically than the nation's as a whole. It's a bit of mystery why. While total American cotton acreage declined in 2006, the acreage in Tennessee actually increased, so the decline is not the result of lower production. More likely it is due to the operations of the large cotton brokers located in the Memphis area. Most of the exported cotton credited to Tennessee is the result of the activities of these brokers, and should they shift or change their export operations, the results will show up in Tennessee's export numbers.

Lurking behind cotton, though, is a second worrying trend. China is cotton's major foreign market, and because of the decline in cotton exports, Tennessee sales to China dropped precipitously for the quarter. State exports to China fell over 60 percent, making it by far the state's worst major market for the quarter. (Two small markets, Jordan and Afghanistan, actually fared worse, but each accounts for only several million dollars in exports each quarter.) Looking for the silver lining, if we remove cotton, state exports to China appear much better. They rose seven percent (from \$214 to \$228 million) for the quarter. But this pales in comparison to the performance of the rest of America. Again removing cotton, American exports to China were up more than 20 percent for the quarter—three times better than Tennessee. In other words, Tennessee does not appear to be taking as much advantage of the growing Chinese market as are other states. Though some Tennessee industries are increasing their exports along national lines, particularly primary metal exporters such as iron and copper, others are clearly lagging behind. The state's plastic and chemi-

cal industries are growing relatively slowly in China, compared to other states. (This may be in part a consequence of the success of Eastman Chemical in developing its overseas production.) And the state's industrial machinery sector is also trailing in the Chinese market. Tennessee exports to Hong Kong and Taiwan were also down this past quarter, suggesting that we need to keep an eye on the future performance of Tennessee exporters in this vital region of the world.

A third problem this past quarter, and one that appears to be growing as the year progresses, is a sharp falloff in car and SUV exports. Car exports were off by a full third, while SUV foreign sales dropped 16 percent. This combined for a loss of \$123 million in exports. The largest component of this decline was a sudden reversal in sales to the Gulf States. A great success story of 2005–2006, the expansion of car sales (mostly Altimas specially fitted for the Middle East market) to Saudi Arabia, the U.A.E., Kuwait, Qatar, and Oman all but collapsed in the first quarter of 2007. But lest this seem entirely a fluke, SUV and car shipments to Mexico were also down sharply. SUVs also had a tough quarter in Canada (falling from \$98 to \$56 million). Only an increase in car shipments to Canada has stemmed the tide in the automotive sector.

In other words, after nearly five years of good news, there are clearly clouds on the horizon. After 32 consecutive months of exceeding the national average, Tennessee exporters have finally fallen back in the pack. While the nation continues to increase its exports by just over 10 percent, Tennessee, as we have seen, has fallen into negative numbers.

COTTON EXPORTS WERE DOWN 89 PERCENT FOR THE QUARTER.

This does not mean all is doom and gloom, of course. The medical sector, broadly defined, continues to boom. Chemicals and nonelectrical machinery products also remain strong. Most state markets are healthy. Canada turned in its usual solid performance, growing by nearly eight percent, and Europe and Latin America also turned in solid numbers (the latter in spite of a \$10 million loss in Brazil). The loss of cotton exports produced flat markets in most of Asia, but a huge increase in the sale of turbojets and airplane parts produced an outstanding performance in Singapore. There exports rose from \$69 to \$209 million, pushing Singapore into fourth place among the state's markets for the quarter. Australia grew by more than 10 percent and just missed being one of Tennessee's top 10 markets.

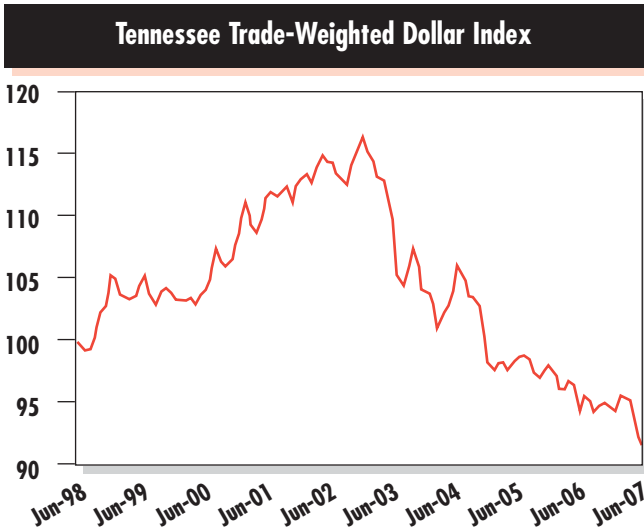
The second quarter is shaping up to be quite similar to the first. State exports are down for both April and May. It's likely we will not see positive numbers again until the losses in cotton work are behind us and the auto industry is able to recover its export losses.■

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medicaments Tennessee buys from Canada, while B.C. sells lumber. Tennessee exports to these provinces, on the other hand, are more varied. Only in Ontario, the destination of most Tennessee automotive shipments, is the export profile narrowly concentrated.



Unbalanced Trade

In a mini-parallel with the bigger American picture, Tennessee exports and imports from Canada have not grown equally. After maintaining a balance for much of the 1990s, imports have begun to outstrip exports. By 2006, an immense trade gap had opened—more than \$3 billion for the year. The lion’s share of this gap, though, is due to the greatly increased cost of natural gas. If we subtract natural gas expenditures from the trade balance, much of the deficit disappears. On the other hand, this deficit began in 2000, before the big gas price increases, and so we should not be too quick to blame it all on one product. For better or worse, the balance of this trading relationship has deteriorated over the years, as has America’s more generally.

The Future

Canada is, and will long be, Tennessee’s most important foreign trading partner. The past decade has greatly increased the amount of trade with Canada and the variety of products traded. Although 2007 is not developing as a particularly strong year—Tennessee’s Canadian exports are flat thanks to a fall in automotive shipments—Canada’s most salient feature as a market remains its consistency. Over the past two decades, only in 2002 did the state’s exports not increase from a year earlier. Few if any other markets can make that claim. This consistency, when combined with its size, ensures that Canada will remain central to any discussion of Tennessee’s international trade. ■