



GLOBAL IMPACT



A Publication of the Ocean Marine Division of Great American Insurance Group

2Q10 No. 52



ALTHOUGH TENSIONS MOUNT, THE U.S. AND CHINA MUST COOPERATE

A DEEPER LOOK REVEALS TRADE DISTORTIONS AND MUTUAL DEPENDENCE

Dear Friends:

U.S.-Chinese relations have become less than optimal. In fact, the growing number of contentious issues—as well as trade distorting data that doesn't reflect today's economic realities—has further complicated problems. What will the future hold for the two superpowers? Read the most likely scenario to this trillion yuan question (p1-2).

The towing vessel industry soon will be required to adopt new federal regulations. This could impact underwriters, surveyors, owners/operators, cargo owners and others (p3).

As the deepest recession since the Great Depression recedes, American manufacturers are preparing for a more competitive global business environment of leaner and more efficient companies. How are they doing this? (p4).

We hope you enjoy this issue and welcome your comments.

Sincerely,

John A. Rowney
Division President
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There are a number of issues causing friction between the United States and China. From the Middle Kingdom's Indigenous Innovation rule, which favors Chinese technology companies over American ones competing for government procurement contracts, to the arbitrary exclusion of American products in the Chinese marketplace, difficult issues continue to mount.

During a May 24th speech in Shanghai, U.S. Chamber of Commerce President and CEO Thomas Donohue said, "Overall, our member companies tell us that their experiences in China's market are positive and profitable. Yet ... concerns have risen to the highest level I have seen in 10 years." Based on today's new economic and political realities, what does the future hold for the world's two superpowers?

THE U.S.-CHINA TRADE DEFICIT

The U.S. deficit with China, which reached \$227 billion in 2009, continues to cause much tension in U.S.-Sino relations. According to economists, a growing trade deficit is dangerous. But, due to new sophisticated supply chains and co-production practices, the factory floor now spans the globe. Many of these economic realities—several of

which benefit the United States—are not reflected in today's metrics and may distort our understanding of what's actually occurring.

VALUE-ADDED FIGURES ARE IMPORTANT

Today, instead of flowing directly to America, much of Asia's exports first go to China for assembly, and then to the U.S. and the rest of the world. Unfortunately, conventional trade statistics don't reveal this changing trade pattern. To grasp a more accurate picture, it's important to identify how much value is added when a country manufactures, processes or assembles goods.

According to the U.S. International Trade Commission (ITC), Chinese value-added, as a component of Chinese exports, is about 50 percent. Stanford Professor Lawrence Lau puts this figure at 37 percent. And based on additional ITC analysis, this figure drops to 35 percent of the value of goods produced in Chinese export zones. This means half to two-thirds of the value of Chinese exports are of non-Chinese origin.

The Apple iPod® manufacturing process is telling. On the back of each iPod is the statement, "Designed by Apple in California and assembled in China." However, traditional data assessments

don't disclose this fact. What's more, the U.S. import cost from China of an iPod, according to the University of California, is \$150. Yet, only about \$4 of this is Chinese value-added derived from Chinese labor and components; the remaining \$146 represents the value of components produced in the United States, Japan, Singapore, Taiwan and Korea. In addition, the U.S. retail price, at \$299, handsomely compensates U.S. retailers, distributors, logistic companies, marketers, researchers and Apple shareholders. Yet, based on conventional metrics, the entire \$150 iPod import figure is applied to the U.S. trade deficit and is perceived as having a bad effect on the U.S. economy.

THE RMB & PASS-THROUGH RATES

The value of the renminbi (RMB), also known as the yuan, is undervalued by 25 percent on a trade weighted basis (JPMorgan says 10 percent), and 40 percent against the dollar, says Fred Bergsten of the Washington, D.C.-based Peterson Institute of International Economics. The conventional argument goes: if China raises the value of the RMB, Chinese exports to the U.S. will become more expensive. In turn, fewer Chinese products will be purchased by Americans—bringing down the U.S. trade deficit. But due to today's complex variables, including pass-through rates and the availability of domestically produced substitutes, textbook theories don't always hold.

For example, if an importer's national currency falls by 10 percent and the cost of imports rise by 10 percent, the pass-through rate would be 100 percent. In turn, the weaker currency would reduce import demand. But today, many types of imports, especially consumer goods, typically have not become more expensive as the value of the dollar has come down. Why? In some cases, exporters to the U.S. are reducing prices and accepting smaller profit margins in order to

maintain U.S. marketshare. Thus, real pass-through rates are significantly less than 100 percent.

A deeper look bears this fact: between July 2005-July 2008, the RMB appreciated 21 percent against the dollar. Yet, the U.S. trade deficit with China rose by 33 percent. Likewise, from 2002-2005, despite considerable dollar appreciation against the Canadian dollar, euro, Japanese yen, Korean won, and Brazilian real, the U.S. trade deficit with each country rose. The bottom line: although the Chinese RMB is undervalued causing a multitude of problems, boosting its value is unlikely to have a significant impact on the U.S. deficit, noted former Federal

States' by 2020, means that country may rely less on U.S. markets. And thirdly, China is quickly moving up the technology food chain. It is now the world's largest maker of wind turbines, a leading producer of solar panels, and is likely to become a leading manufacturer of hybrid and all-electric vehicles.

Overall, a more confident China is focusing on what it believes is right for itself: developing its own technologies, creating national champions and protecting certain strategic sectors. In turn, many U.S. and foreign business leaders say China is less accommodating. On the other hand, 93 percent of the U.S.-China Business

A more confident China is focusing on what it believes is right for itself: developing its own technologies, creating national champions and protecting certain strategic sectors.

Reserve Chairman Alan Greenspan. Even if the pass through rate was 100 percent and the price of Chinese goods rose enough to discourage imports, U.S. buyers likely would still seek lower-cost imports from other developing countries like Vietnam. Instead of focusing on the RMB—which is anticipated to slowly rise over the next few years—it may be wise to concentrate on more significant factors to correct U.S.-China imbalances.

A NEW CHINESE CONFIDENCE

Even though the Chinese leadership continues to fear instability, that country has developed a new post-Great Recession confidence for a variety of reasons. Firstly, the Margaret Thatcher-Ronald Reagan model of free market capitalism—that jump started this era of globalization and created tremendous global economic opportunity—has lost some degree of credibility. Secondly, Chinese global consumption, which is projected by Credit Suisse to match the United

Council survey respondents say they are optimistic or somewhat optimistic on their five-year outlook.

WHAT'S AHEAD?

In its quest for a secure source of raw materials and policies that will ensure growth well into the 21st Century, China is becoming more assertive around the world. Nevertheless, China—and the United States—understand the need to cooperate. Although Chinese domestic demand is becoming stronger, that country will continue to need access to U.S. markets; the U.S. will need China to continue financing its debt. And both grasp the importance of working together on Iran, North Korea, the fight against terrorism, and climate change, to name only a few.

Both the U.S. and Chinese leadership understand what's at stake, as well as the impact of a China-U.S. Cold War, and are likely to cooperate well into the future. ■

COAST GUARD INSPECTIONS OF TOWING VESSELS

COMING SOON: NEW REGULATIONS KNOWN AS SUB-CHAPTER M

By PETER SQUICCIARINI

Enhancements to marine safety, accident and loss prevention, as well as risk management, are expected as the towing vessel industry adopts new federal regulations. This could impact underwriters, surveyors, owners/operators, cargo owners, and others.

THE DETAILS

With over 5,000 tow boats in service, the towing industry, commonly referred to as the “Brown Water” segment, is a substantial part of the marine industry and will be impacted by new rules. But stakeholders that need to take notice aren’t limited to vessel owners and operators. Marine underwriters, surveyors, cargo and vessel support customers also are players in the Brown Water business and can play a beneficial role.

Currently, most tow vessels are “uninspected.” This means they do not require a USCG Certificate of Inspection. Nevertheless, they are still subject to and regulated by the Code of Federal Regulations (CFR). When implemented, new regulations known as “Sub-Chapter M” will require tow vessels to be inspected by the Coast Guard. Once this occurs and a vessel is compliant, a Certificate of Inspection (COI) will be issued. The vessel will then operate as an “Inspected” vessel.

Sub-Chapter M is currently in the rule making process. When published in the Federal Register, a period of time will be set aside for public comment by the marine industry, including underwriters and surveyors. Comments, which may shape the rules, will be reviewed by the Coast Guard prior to enactment.

WHAT’S AT STAKE?

What’s at stake for underwriter and towing industry customers with regard to tow vessel compliance and marine safety? Profits, losses or even worse. It’s often said that safety rules and regulations are written on the heels of accidents, sometimes deadly and often costly. Sub-Chapter M is a solid step designed to prevent problems from occurring in the first place. But it can only be effective if insureds are compliant. And, as we all know, it’s a poor business practice to take on an insured risk with only the hope that minimum compliance standards are met.

TOWING VESSEL BRIDGING PROGRAM

In an effort to increase marine safety, the towing industry and organizations such as the American Waterways



Guard. This, no doubt, will help ensure that vessels and their crews are operating within the rules—a fundamental prerequisite to insurability and safe customer service. As a result, we hope the marine insurance industry will encourage their clients to engage the Coast Guard and pursue towing vessel safety examinations. Additionally, we recommend

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Operators (AWO) have partnered with the U.S. Coast Guard. This and other types of collaboration are welcomed. Sub-Chapter M regulations have been a collaborative effort between the Coast Guard and vessel owners, operators, and advisory boards. The marine underwriting industry is invited to participate as well.

Recently, the Coast Guard established the *Towing Vessel Bridging Program*. It is designed to help the towing industry prepare for Sub-Chapter M compliance by encouraging vessel owners and operators to voluntarily have their vessel examined by the Coast

that marine underwriters require surveyors to verify full compliance when attending the vessel. Click here for more information and to obtain the *Uninspected Towing Vessels Guide Book* (see Uninspected Vessels located under Domestic Vessels). Remember: for marine safety and compliance, everyone is in the same boat. Sail safely. ■

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U.S. MANUFACTURERS ARE ADAPTING TO TODAY'S NEW ECONOMIC REALITIES

POST-GREAT RECESSION WORLD DEMANDS GREATER VALUE, AND MORE GLOBAL PARTNERSHIPS AND M&AS

As the deepest recession since the Great Depression recedes, American manufacturers are preparing for a more competitive global business environment of leaner and more efficient companies. How are they doing this?

MORE MERGERS & ACQUISITIONS

"Many manufacturing companies are cautiously shifting gears from retrenchment to expansion as activity revives and credit markets improve. After nearly two years of focusing on cash and liquidity preservation and cost reduction, they are now looking to build capacity and explore growth opportunities," according to a recently released study by Deloitte Consulting LLP. How are they planning on achieving these objectives? Nearly 45 percent of manufacturing respondents to a Deloitte survey said they are highly likely to or will definitely contemplate pursuing mergers and acquisitions. Two-thirds of respondents are "most likely to pursue target company with adjacent product lines, or make a horizontal move on a competitor," the report says.

MORE FOCUS, COOPERATION & VALUE

In addition to more M&As, large manufacturers are increasing their dependence on suppliers of components as they streamline their operations to

increase productivity, says Jerry Jasinowski, former president of the Manufacturing Institute, the research and educational arm of the National Association of Manufacturers (NAM). Why is this occurring? As the level of competition rises, manufacturers are forced to specialize to a greater extent in order to become leaders or retain leadership in their core competencies. To achieve this, they are increasingly focusing on their strengths and shedding non-core functions. This trend benefits small and

medium size manufacturers (SMMs) by enabling them to take over new production functions and further integrate themselves into the supply chains of large manufacturers. Plus, to boost competitiveness, many SMMs are becoming more entrepreneurial and offering customers value that low-cost country suppliers can't match. This includes proprietary high-technology products, a willingness to customize, extraordinary service and parts support, flexible production runs and fast turnaround times, " Jasinowski says.

MORE GLOBAL ENGAGEMENT

SMMs also must seek new partners at

every stage of the global supply chain, including research and development, manufacturing, packaging, shipment, service and support, says a NAM study. "By connecting with outside resources—customers, government and academia—SMMs can swiftly expand their core competencies and gain economies of scale," said John Engler, President and CEO of NAM.

Importantly, the number of small business exporters tripled over the last

Many SMMs are becoming more entrepreneurial and offering customers value that low-cost country suppliers can't match.

decade. And increasing numbers of executives at SMMs indicate that global business is the driver most likely to influence their company's purchasing and supplier-management strategy in the future. This is likely to result in even more international growth.

MORE CREATIVE THINKING

American SMMs are placing more emphasis on improved product design, quality, branding strategies, and improved responsiveness to customer needs. These and other strategies will help SMMs seize new opportunities not widely recognized before. They also will help reduce new risks. ■

For more information on how we can help your business stay profitable, contact your agent or **Ed Wilmot** at (212) 510-0135 and ewilmot@gaic.com

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