



GLOBAL IMPACT



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CHINA'S SHIPBUILDING INDUSTRY, THE WORLD'S LARGEST, EVOLVES

BETTER UNDERSTOOD WHEN ADJUSTING FOR PURCHASING POWER PARITY

Dear Friends:

Last year China surpassed Korea to become the world's largest shipbuilder. It also possesses seven of the world's 12 largest ports measured by container traffic. What's next? (p1-2).

Cyber crime is expanding exponentially. In fact, more than 350 million personal records were exposed to cyber breaches in the last five years. What's more, each data breach event costs an average of \$7.2 million. In an effort to reduce corporate risks, Great American announces its new and unique Cyber Risk Insurance. (p3).

Many American products that were previously offshored may be backshored. Read about new trends occurring in the U.S. as well as in China. (p4).

We hope you enjoy this issue and, as always, welcome your comments.

Sincerely,

John A. Rowney
Divisional President
Ocean Marine Division

Due to efforts to increase capacity along with government incentives to promote the industry, China surpassed Korea last year to become the world's largest shipbuilder. In 2010, China's shipbuilding output reached 65.6 million deadweight tonnage, according to the National Bureau of Statistics of China. This represented an increase of 54.6 percent over 2009. The China International Marine, Port and Shipbuilding Fair says there are approximately 3,000 shipbuilding enterprises in China.

According to the report, *A Comprehensive Survey of China's Dynamic Shipbuilding Industry*, published by the U.S. Naval War College, Beijing has a strong comparative advantage in shipbuilding, which is focused on commercial vessels. Its capability also is increasing rapidly.

THE CHINESE INDUSTRY EVOLVES

"When vessels were built of wood, the easy availability of this material made the United States the first major player in shipbuilding in the early part of the 19th century," states the Organisation for Economic Co-operation and Development (OECD), an inter-governmental organization headquartered in Paris. As wood was replaced by iron and steel in the 1850's, Britain took over the lead, until 1956 when Japan became

the number one shipbuilder.

During the 1980s recession, the global shipbuilding industry declined considerably due to lack of orders and the subsequent oil crisis. The OECD estimates half the shipyards worldwide shut down during this period. Then, as economic growth accelerated in the 1990s, industry dominance moved to the Far East.

"The present development of the Chinese shipbuilding industry follows a similar pattern to what happened earlier in Japan and Korea. Japan used its shipbuilding industry in the 1950s and 1960s to rebuild its industrial capability, while Korea saw shipbuilding as a strategic core for its economic development in the 1970s," the OECD says. China also is seizing the shift toward lower cost production and its strong domestic demand to build a solid industrial foundation.

But bigger doesn't always mean better. Stated in May 2010 in the *Global Times*, a Chinese daily, "Although China overtook South Korea and Japan to become the world's largest shipbuilder in terms of shipbuilding capacity, overtaking orders and new orders, the country's high value-added shipbuilding ability is far behind the two countries... We must recognize the data is just about the volume of deadweight tons

Continued on page 2

(a ship's carrying capacity with crew and supplies), not about their total value (the ships)."

A GLOBAL VIEW

Reportedly, 80 percent of the world's shipbuilding industry is located in China, Korea, Japan and the European Union (EU). It is an important and strategic industry the EU government claims, and the EU says there are more than 300 EU shipyards while approximately 40 of these are active in the global market for large sea-going vessels.

Due to various strengths and weaknesses, EU ship production is concentrated in high value segments, such as cruise ships and other types of high-technology or specialist vessels, including fast ferries and dredgers.

Where does the United States stand? The U.S. builds the world's most technologically advanced warships, but remains non-competitive in the large commercial vessel international market. The U.S. Naval War College says this is a cause for concern.

CHINA'S SHIPBUILDING FUTURE

It appears that China intends to move up the shipbuilding technology chain. According to a report published by the National University of Singapore's East Asian Institute,

China is taking advantage of the demand shift toward centers of low cost production, and making full use of its low cost advantage and large domestic demand to build a solid industrial foundation.

China plans to invest more in "high-tech and high value-added technologies, such as environment-saving and energy-efficient shipbuilding, maritime equipment projects, and critical internal equipment within ships."

In an effort to help the industry overcome problems associated with reduced global demand, in February 2009, the Chinese government imple-

mented "The Plan on the Adjustment and Revitalization of the Shipbuilding Industry," which promotes mergers and acquisitions and encourages indigenous innovation and R&D.

PURCHASING POWER PARITY

To better understand China's ability to produce such large shipping tonnage, it helps to understand purchasing power parity.

In 2010, total U.S. gross domestic product, at \$14.7 trillion, was more than twice China's \$5.8 trillion, according to the International Monetary Fund. But when adjusting for purchasing power parity, which reflects relative prices of similar commodities in the various countries, Chinese economic output already surpasses U.S. output, says Arvind Subramanian, senior fellow at the Peterson Institute for International Economics and the Center for Global Development, and senior research professor at Johns Hopkins University.

Using purchasing power parity, Subramanian anticipates the Chinese economy will be twice as large as the United States' by 2030. Not surprisingly, he says, traditional market exchange rates exaggerate American capability.

On the other hand, Chinese

capabilities may have been underestimated. As such, China may have the ability to produce more than traditional metrics would suggest.

Estimates of purchasing power parity take account of differing costs and are an alternative to computing standards of living and economic output across countries. On this basis, says Subramanian, the average Amer-



ican is only four times as wealthy as the average Chinese citizen, not 11 times as rich as conventional numbers suggest. "The different approaches to valuing economic output and resources are not just of theoretical interest. They have real world significance, especially in the balance of power and economic dominance," he says.

What does this mean for the Chinese shipbuilding industry? Based on purchasing power parity, China's tremendous output can be better understood.

And with the knowledge that global trade will continue to be a critical factor in China's future growth, it is no surprise that China possesses nine of the world's 14 largest ports measured by cargo volume, and seven among the world's top 12 measured by container traffic. ■

GREAT AMERICAN REDUCES CYBER CRIME RISKS WITH ITS NEW AND UNIQUE CYBER RISK INSURANCE

GROWING RISKS REQUIRE NEW SOLUTIONS

Cyber crimes often involve an illegal computer or network data breach that results in identity theft. One of the fastest growing crimes in America, identity theft affects approximately 9-15 million people annually, according to data provided by the Federal Trade Commission and Gartner, Inc., a leading information technology research and advisory company. And its costs, which range in the tens of billions of dollars annually, are mostly borne by businesses.

Identity theft is a form of fraud whereby one person assumes the identify of another in order to access his or her resources, credit or other benefits in that person's name. And data breaches, which typically involve unauthorized intrusions into consumer databases or credit card processing systems to obtain this sensitive information, are becoming all too common and extremely costly.

In fact, according to the Ponemon Institute, a research organization dedicated to privacy, data protection and information security policy, more than 350 million personal records were exposed to breaches from 2005 through 2010. What's more, each data breach event costs an average of \$7.2 million; each compromised record costs \$214.

Growing cyber crime has put increasing pressure on companies to better protect their consumer data and have sound plans in place should a breach occur. To this end, in 2007 the Federal Trade Commission, in association with other organizations, established *Red Flags'* final rules designed to help financial institutions and creditors, such as banks, auto and boat dealers, and other transaction account-based companies detect identity theft by requiring them to establish prevention programs. Plus,



notification laws to inform consumers if their files are compromised are in effect in most states.

Although a large percentage of breaches involve online computer database intrusions, more than one-

employee error. As a result, companies of all sizes need to have plans in place to guard against cyber risks, as well as policies to contain damages, says Capt. Ed Wilmot, Vice President of the Great American Ocean Marine

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third involved lost or stolen laptops or other mobile devices in 2009, the Ponemon Institute says. Laptops stolen in airports or from vehicles can be more valuable to criminals than robbing banks.

But for companies responsible for securing the data, the damages can be tremendous and involve lost business, negative publicity, and the need to remediate claims, restore stolen data, and inform each person whose private information may have been copied.

Data breaches are not always perpetrated by sophisticated criminals. According to Ponemon, 40 percent are the result of simple negligence or

Division. "The need for cyber solutions has never been greater," Wilmot explains. "That's why we now offer Cyber Risk Insurance for boat dealers, marinas and others."

Great American's Cyber Risk Insurance responds to a wide variety of data breach risks, including situations involving company liabilities caused by a breach, as well as expenses associated with crisis management, notification of customers to comply with regulatory laws, and other security breach related expenses.

For more information, contact Capt. Ed Wilmot of Great American Insurance Group at ewilmot@gaic.com or (212) 510-0135. ■

CHANGING DYNAMICS IN AMERICAN MANUFACTURING

DUE TO NEW TRENDS, MANY PRODUCTS OFFSHORED WILL BE BACKSHORED

Surprising to many, when companies decide where to invest abroad, labor costs are only one of many factors considered. Other factors, which often are more important, include the availability of skilled workers, productivity levels, the quality of local infrastructure, political stability, rule of law, proximity to key markets, and ability to repatriate profits. That's why the U.S. remains on top.

With the exception of the year 2003, the United States continues to be the world's largest recipient of foreign direct investment. And nearly 40 percent goes into manufacturing, according to the Organization for International Investment, a business association in Washington D.C.

WHEN CHEAP LABOR IS KEY

Production of low tech goods, that typically requires fewer worker skills, tends to be offshored to the next low cost country. This trend, which began with industrialization in Great Britain, observed low tech production moving from Britain to the U.S., then to Japan, Taiwan, and S. Korea, and more recently to China and other developing countries.

America—which now specializes in high technology production—knows this well. Since the 1970s U.S. firms began offshoring low-technology manufacturing operations and related jobs. But a number of new factors have influenced this trend.

NEW TRENDS CHANGING OLD PATTERNS

In recent years, China has absorbed much of the world's low tech production. But if U.S. consumers are the primary market destination, as opposed to Chinese or other Asian consumers, the Middle Kingdom may no longer be the best location. Why?

For several years, Chinese labor rates have increased 17 to 18 percent annually. If sustained, this, combined with a slow appreciation of China's currency, could result in employment cost increases of 20-25 percent per year, analysts say. Plus, ever-increasing fuel costs and expenses related to global supply chain logistics and long distance management, as well as capital outlays associated with longer lead times and larger inventories, further reduce China's low cost advantage. In addition, costs of engineers, purchasing managers and quality control staff traveling to China add up. As a result, The Boston Consulting Group says within the next five years, the U.S. will experience a "manufacturing renaissance" as the wage gap shrinks between China and states such as Mississippi, South Carolina and Alabama.

Boston Consulting estimates that wages account for 20-30 percent of a product's costs. Susan Helper, a professor of Economics at Case Western Reserve University, says in most manufacturing facilities, it's more likely between 10-20 percent. If true, countries with low labor costs will

hold a decreasing advantage. Consequently, for many manufacturers, it makes sense to "backshore" or return some previously offshored lower tech manufacturing to the U.S.

AMERICAN MANUFACTURING STRONG

U.S. manufacturing employment has declined from a high of 19.5 million workers in 1979 to 11.7 million in May 2011. This primarily is due to American innovation and technology, and resulting productivity gains, which rose at an annual average rate of 3.9 percent from 2000-2007 and is considerably higher than productivity in the non-farm sector. This has enabled fewer workers to churn out more products quicker. Consequently, from 1979 to 2010, American manufacturing value added output more than tripled, from \$545 billion to more than \$1.7 trillion.

We've seen these trends before. In 1940, 9.5 million U.S. workers were employed on farms. By 2010 this number fell to 2.2 million. Yet, U.S. agricultural output skyrocketed.

American manufacturing remains strong. But few realize this since U.S. products typically are not visible on retail shelves. So what happens now? Some production of lower tech products dedicated to U.S. consumers, which previously was offshored, will relocate to low cost states, while other U.S.-based production considered to be offshored will remain here. ■

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

Great American Insurance Group, Ocean Marine Division
65 Broadway, 20th Floor, New York, NY 10006

www.GreatAmericanOcean.com



The cyber risk insurance described on page three is underwritten by Great American Insurance Co. of New York which is an admitted insurer in all fifty states and DC. Coverage description is summarized. Refer to the policy declarations and policy form for a complete description of all applicable terms, conditions, limits and exclusions.

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