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Manufacturing's Distress - - The Role of Imports?

Recently, we have been discussing the domestic manufacturing sector and ways it could be revitalized. In considering various possible measures that might be taken to achieve that end, one should look with some care at what exactly has happened to manufacturing.

One statistic that sticks out is the number of workers employed in the sector, and that figure is quite dismal. Since 1979, when there were almost 20 million employed in manufacturing, we have lost some eight million jobs. Even discounting the effects of the current recession, about 25% of those jobs were lost between 2000 and 2008.

There are some other indications, however, that suggest that the sector is not doing that badly. For example, gross dollar output of U.S. manufacturers has about doubled since 2000, again disregarding the recent downturn. In fact, the share of real GDP represented by real manufacturing output has remained fairly steady for the last half century. What then, happened to all those jobs?

The answers to that question that have been suggested include the following:

- Labor productivity has increased dramatically. Fewer workers are making more products.
- There has been a trend towards hiring temporary and contract workers in manufacturing facilities. These workers reduce the measured level of employment in manufacturing enterprises.
- There has been a shift in the U.S. demand away from manufactured goods towards services.

If these explanations are correct, one might argue that there really isn't a problem here; the workers might have taken it on the chin but the businesses are doing ok. On the face of it, that conclusion looks absurd to those of us in the trenches. But why? Here is what some analysts have said:

- Gross manufacturing output includes a good deal of cheap imported components and raw materials, thus inflating the value added by "domestic" production and as well as its share of GDP.
- There hasn't been a shift in demand. Manufactures, both domestically produced and imported, have accounted for about 20% of total domestic demand for the last twenty years. What has changed is the share of that demand supplied by net imports, which went from about 7% in the early '90s to around 25% today. Depending on the period chosen, estimates have suggested that our trade deficit in manufactured goods is responsible for from 30% to 60% of the job losses occurring before the current recession.

These conclusions by the economists confirm what we know firsthand from seeing our customers and other companies abandon their production in the U.S. and either start up facilities abroad or buy finished products from foreign suppliers for resale here. Those events can only reduce employment in the U.S. manufacturing sector. And, thus, the loss of jobs is not just the unfortunate side effect of benign increases in productivity and shifting of customer preferences; it represents a critical injury to our manufacturing base.

What to do about it? We have long pointed out that it is not "protectionism" to insist that our trading partners follow the international rules. In today's economic world, the U.S. cannot afford to act as if forcing exporting countries to desist from unfair trade practices runs contrary to principles of "free trade". (Even the New York Times, never a friend of our trade laws, recently recognized that China's currency manipulation is so egregious that it risks and perhaps deserves retaliation unless it is ended.)

The recession is teaching us that even the ability to make high quality, low cost products will do us little good if there is no one to buy them. We are laboring under a huge burden on our consumer based economy caused by high unemployment. While recovery will mitigate that unemployment as things improve, something more needs to be done to stanch the job losses in manufacturing caused by unfairly traded imports. We shall address some of the ideas that have been suggested on that subject in future letters.

Here are some of the data on cost factors for this month:

- Scrap and Pig Iron The prices for #1 dealer bundles and #1 busheling (Chicago) continued their climb to \$380 and \$390 per mt, respectively, or about 13% above last month. These levels are far below the record (\$890) set in mid 2008, but they are otherwise higher than any prices since September-December, 2004. One can only hope that the increased demand for scrap may evidence some new spark of life in the market for steel products. Pig iron was also up this month, to \$375 per mt, an increase of 5%.
- Natural Gas The Nymex contract price increased by 47 cents to \$5.57 per mmBtu. This is still below the prices that were obtained for most of the six years before the current recession, but the trend has been upward for the last four months, and the price is almost twice what it was last September.
- Ocean Freight The Baltic Capesize Index took a dive this month to 3759, more than 2000 index points below last month. This seems to be a counter indicator to scrap prices, whose increase suggests that there would be greater demand for ocean carriage, at least if sales for export were driving the prices.
- Exchange Rates The dollar weakened slightly from last month. The euro (at this writing) is at \$1.44, up a penny, and the pound is at \$1.63, up two cents. The Canadian dollar gained four cents to \$0.97.

We are interested in your comments and suggestions, so let us continue to hear from you. As usual, this letter will be available on our website, www.coreysteel.com and on the international site, www.steelonthenet.com.