

2012 Cross-Border Roundtable: Will hemispheric trade gain traction?



While Mexico and Canada remain our primary international trade opportunity, *LM's* analyst panel tell us that bolder players will be exploring more distant markets once the Panama Canal expansion is complete.

BY PATRICK BURNSON, EXECUTIVE EDITOR

Last year at this time, trade analysts speculated that the risk/reward for U.S. shippers doing business in Mexico and Canada was approaching a positive balance. However, our panel tells us this year that hemispheric alternatives may be looming and that some multinationals may hedge their bets by investing in “hybrid” transportation solutions in the future that include air and ocean options. By all appearances, it may not be just “surface modes” forever.

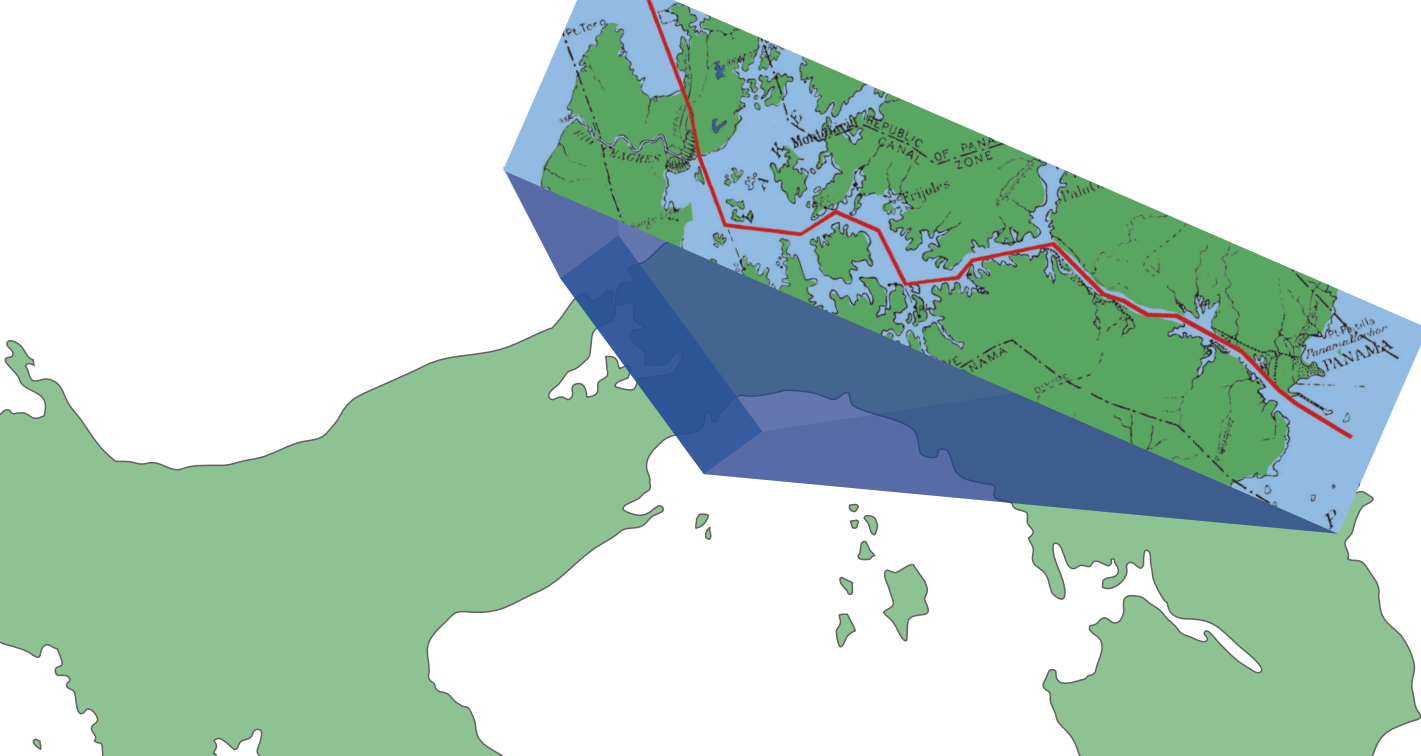
Joining us in our annual discussion of the state of cross-border trade and the North American Free Trade Agreement (NAFTA) are William Neilson, holder of the J. Fred Holly Chair of Excellence and professor of economics at the University of Tennessee’s College of Business Administration; Foster Finley, managing director and head of the Logistics & Distribution Practice at AlixPartners, an international trade consultancy; Daniel Griswold, the newly-named president of the National Association of Foreign-Trade Zones; and Edgar Blanco, research director at the MIT Center for Transportation & Logistics.

Logistics Management: Let’s address the current state of NAFTA. Have you seen a shift of trade away from the region? Some analysts, for example, are telling us that Caribbean Basin sourcing seems to be ramping up.

Foster Finley: This varies by industry, with garments and other soft goods certainly being sourced from the Caribbean Basin. However, we’ve seen a recent shift in NAFTA sourcing from industrial companies that want to bring the supply base back from China and other Far East locations—usually to Mexico.

Daniel Griswold: Our trade with Canada and Mexico has matured as NAFTA has become fully implemented. They remain our two largest trading partners in terms of two-way trade, but their share of total U.S. trade has been in slow decline for the past decade as the emerging markets grow as a source of imports and as a market for exports.

Edgar Blanco: Actually, there has been a reduction of sourcing from Mexico as a consequence of the financial crisis and re-alignment of global supply chains. The violence surge in Mexico has had some impact, but the Mexican economy is still growing at a healthy pace (3 percent to 4 percent). I have not seen any large scale threat from the Caribbean Basin as of yet.



William Neilson



Foster Finley



Daniel Griswold



Edgar Blanco

LM: Do you agree that today's shippers are more likely to "go global" by starting in Canada and Mexico before exploring more far flung markets?

Griswold: I would say that's still true. There are more than 250,000 U.S. companies now exporting, and a large share of them are small- and medium-sized enterprises—but most still only sell in one other country. Canada and Mexico are the most common lone markets because of proximity and NAFTA, but that could be changing as the Internet and 3PLs make global commerce more accessible for smaller companies. Keep in mind that more markets are opening due to the recent U.S. trade agreements, such as the U.S.-Dominican Republic-Central America Free Trade Agreement (CAFTA) and new agreements with South Korea, Colombia, and Panama.

William Neilson: I agree with Daniel. If companies are not currently concentrating on trade in this hemisphere, they should. With the uncertainty surrounding Europe, especially the Euro, countries with close economic ties to the United States are likely to provide more stable customer bases and more stable supply bases than countries with weaker ties. Canada and Mexico are the obvious choices here, although any country whose economies are insulated from Europe would also be an attractive partner.

Finley: I don't necessarily agree. This will vary by commodity and industry, but there are still opportunities to skip the closest "near shore" option and outsource to Asia or Eastern Europe. However, the NAFTA option is becoming more and more attractive due to currency, proximity, labor rates, capabilities, and transportation considerations.

Blanco: Foster makes a good point. With so much growth in China, Brazil, and India, I see more companies starting on those distant emerging markets first. Mexico and Canada are attractive, but with 9 percent to 10 percent growth rates and an emerging middle class, shippers are looking at those emerging markets more aggressively. I can see a certain group of risk adverse shippers keeping their investments "close," but the emerging markets are too important. Also, there will be very little "learning" from starting in NAFTA. The lessons are confined to one region, so you may be better off going to larger markets right away.

LM: When we talk of cross-border we generally think of truck, rail, and intermodal. Should shippers be looking at sea and air options as well?

Griswold: Absolutely. As the stuff we produce becomes more technologically sophisticated, the ratio of weight to value keeps dropping. This means air freight is becoming more and more important. More than half the value of what we export to the rest of the world now leaves the U.S. on airplanes, not ships. This is a big reason why foreign-trade zones are located near major airports as well as seaports.

Neilson: That's very true, and for the last few years we have seen large increases in volatility in virtually every market. New economic research shows that companies can increase their profits by using faster transport, specifically air transport, in response to rapid market fluctuations. The basic strategy involves using slower, more traditional transport for fairly stable demand situations, but faster transport for more volatile ones.

Finley: Conceptually this makes sense, but execution has been a challenge.

Blanco: I agree with Foster. I don't see air and ocean being a major player within NAFTA, but it will always be in the mix. Once the Panama Canal opens there may be some new opportunities for sea with new feeder routes being developed, but they will be limited.

LM: What role is software and technology—GTM systems for example—playing in meeting today's cross-border trade challenges?

Blanco: I'm always bullish about the role of technology in facilitating global operations. Software enables visibility and agile decision-making, and any business without basic tracing or tracking software will not survive in a competitive environment.

As companies go global, the same applies for trade management and other supply chain solutions. Spreadsheets will get you by while you sort out the operational aspects, but to achieve growth, more complex investments are needed like master data or sales and operation planning (S&OP) enabling solutions.

Neilson: I believe the use of high-quality supply chain management software should increase, and there are two good reasons. First: shipping delays are expensive. Recent economic research shows that an extra day in transit has a cost, on average, equal to about one half of a percent of the *ad valorem* shipment value. Second: so much of shipping involves

informational inputs, and companies that try to hold down inventory costs want to keep their shipping schedules tight. Software can help with this.

LM: What are the new regulatory obstacles that surfaced for cross-border shippers over the past 12 months?

Finley: While the never-ending HOS saga is still a dark cloud over the heads of shippers and carriers, the most interesting developments are certainly the expansion of the NAFTA cross-border traffic regulations for Mexico and the increased weight restrictions for northern intra-state traffic.

LM: One might argue then that choosing the right transportation partner cannot be overstated. We keep hearing about the advantages of using a 3PL or 4PL, or going directly to the carrier for cross-border trade. Where do you come down on these trends?

Finley: We believe that the companies that have made the investments in the recent years to enable the NAFTA super-highway will continue to dominate. The use of 3PLs and 4PLs are excellent strategies to gain specific capabilities and leverage within a given carrier base, but be careful which partner you choose. When capacity is outstripped by demand, which is starting to occur right now, not all 3PLs and 4PLs are created equally. You want to be able to secure capacity at the right time and at a fair cost, which may become more challenging in the near term.

Blanco: My advice is to ignore the trends. The value of 3PLs or 4PLs is very dependent on the operational strategy. What are the skills in my company? Will logistics be part of my competitive advantage? How do I transition in/out a 3PL/4PL? What are the risks of going directly to carrier? My advice has always been to not rule out any option. You need to do your homework, and you may have the strength in house.

LM: Can you provide a forecast for cross-border trade growth?

Neilson: The elephant in the room for any forecast is the state of the world economy. Although the data show that trade flows have made up the ground they lost in the recession, concerns are growing that this upward trend might end

soon. Right now, the world economy is being driven by pressures for austerity in Europe and also possibly in the U.S.

And while these austerity measures might have positive implications for long-run growth, it's hard to see how they would lead to more international shipments, or even domestic shipments, in the short run, especially because the World Bank and others predict a global slowdown for 2012. Countering this, however, is the increased trade out of Japan as it recovers from last year's earthquake and tsunami.

Griswold: Historically, trade growth depends heavily on the underlying growth of the domestic and global economies. If the U.S. can maintain a normal rate of growth of say 2.5 percent to 3 percent, and the world economy can keep chugging along despite worries about Europe, U.S. trade will probably keep growing at its historical norm of around 7 percent. If major economies tank, then all bets are off and trade will suffer another downturn, as it did during the 2008-2009 recession.

Finley: I'll add that considering the supply shortages of industrial and electronic components from Japan and Thailand, energy production in Canada, and the recent trend in near shoring, growth in cross-border trade should continue to accelerate.

LM: The consensus is that growth is a given. The one question that remains, however, is what kind of investment in infrastructure here in the U.S. and abroad will be needed to make this sustainable?

Griswold: We need to maintain and modernize our infrastructure to realize the full benefits of trade, there's no doubt. That means expanding port facilities, dredging harbors and upgrading docks to accommodate the post-Panamax vessels that will start arriving at Atlantic and Gulf ports after 2014. This shouldn't require more government borrowing; in fact, trade infrastructure can pay for itself through fees and increased economic activity as well as private development.

Blanco: I believe that the U.S. needs to upgrade its intermodal infrastructure more than anything else. With volatile fuel prices and increased focus on sustainability, a more fine-tuned intermodal infrastructure will make us competitive in this hemisphere. □