

Trade Winds Shifting

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Doreen Huro Micheline lives in a world of multicultural whiplash, navigating through five languages, three time zones and two continents. She clocks so many airline miles that pilots write her personal thank-you notes for choosing their airline. This is savage globalization. Ms. Micheline, the vice president of global operations for Dial Tool Industries Inc., has had to switch manufacturing machinery widgets from Chicago to Mexico. And now, because of client demand, move some production to China. A veteran of global industrialization, her experience illustrates both the promise and the pitfalls of the North American Free Trade Agreement as it nears its 10th anniversary. "We get a lot of finger-shaking and people saying, 'Oh, jobs leaving the U.S.' But I am not there because I want to be," Ms. Micheline said. "I had clients saying, 'You go to China or you will not get any more of our business.'" Dial Tool and its workers in the tool and die industry aren't the only ones facing this threat. From people who supply the parts for America's auto industry to those who make elegant bangles of gold for America's acquisitive consumers, a new "world price" seems to be emerging for certain goods at the wholesale level. The same forces that led to NAFTA's passage now cause some to wonder if the trade pact's success was only ephemeral. China, with its supply of cheap labor and alluring incentives for business investment, is threatening Mexico's success. "The NAFTA advantage was a temporary thing," said Farid Abolfathi, managing director of global macro-economics at the consulting firm Global Insights in Waltham, Mass. "It allowed them to expand market share for a while. Now they are stagnating. We are expanding our free trade with a lot of others."

Like Dial Tool, electronics giant Philips has also heeded a customer's presence for the low prices only China can offer. "We had a customer, Dell, who bought our monitors, who moved with operations to their main manufacturing center to Asia," said Rudy Garcia, a foreign trade and customs manager in Ciudad Juarez for Amsterdam-based Koninklijke Philips Electronics NV. So the company let about 800 Mexican workers go last year and moved that monitor division to China. Those corporate moves illustrate an uneasy transition in the Mexican economy. NAFTA helped solidify economic bonds between the United States and Mexico and, to a much lesser extent, Canada, when it came into effect in 1994. But Mexico's rising standard of living has driven up costs. And China's acceptance into the World Trade Organization in 2001 underscored how cost-effective the Asian giant could be. Huge challenges In Santa Monica, Calif., economist Donald Straszheim calls China "the global change agent for the next quarter of a century." "It is a rare company that would regard the opportunity in Mexico to be as good as it is in China," said Mr. Straszheim, president of Straszheim Global Advisors. So the challenges are huge for Mexico, whose own economy is stagnating while China's has had an average growth rate of 8 percent for most of the last decade. A country of 100 million, Mexico has the world's 10th-largest economy. China, the world's most populous country with 1.3 billion people, ranks sixth, and it's moving up the rankings fast. The apparel and textile industry may serve as a canary in the coal mine that foretells of danger ahead,

experts say. For seven years, Mexico was the top apparel supplier to the United States. That changed last year, when it was surpassed by China. China is also first in footwear, toys, games and sporting goods. Robert Bergés, director of Latin American strategy at Merrill Lynch & Co. in New York, called a few smaller specialized products - modems, handheld computers, mobile phones - "endangered species" that could soon migrate to China. Others wonder what will be next. Mexico has become a significant player of quality in the automobile industry and "white goods" - meaning heavy, boxy refrigerators and stoves. Mr. Bergés and others say Mexico currently has the advantage in manufacturing those boxy durable goods, which would be too expensive to ship across the Pacific Ocean. So it will probably be able to keep those lines. "Mexico keeps its advantage when the specifications of products are very complex or change quite rapidly," Mr. Bergés said. "With just-in-time delivery, you need a supply of inputs quite rapidly. Being next to the U.S. really does matter."

Philips, for example, still has a large presence south of the border, Mr. Garcia said. It employs about 6,000 people in seven plants that produce a variety of electronic products. And China is not necessarily an economic paradise, he and others add. There is a price to be paid for access to what's being termed the global factory. "For the last three years, China has been like the magic kingdom," Mr. Garcia said. "Sometimes companies go there without actually doing a close analysis of what they are doing." That's exactly what Mexican corporate attorneys and government officials hoped to provide last month when they gathered at a "Mexico vs. China" conference in El Paso, sponsored by the trade magazine Mexico Now. Eduardo Solís of Mexico's Ministry of the Economy assured those gathered at the confab that business would go smoothly in Mexico. "Stay away from incredible incentive packages," Mr. Solís warned, because they may not be consistent with global trade rules of the World Trade Organization. Another Mexican attorney, Aureliano Gonzalez-Baz, was more blunt in his criticism: "If you think mañana is a problem in Mexico, go to China and you will beg," he said, pausing for emphasis, "to come back to Mexico." Nearby, a trade attaché from the Chinese embassy prepared his counterattack at the podium. "I do not agree with some of their opinions," said Jianguang Lu, the Houston-based commerce and economics director of the Chinese consulate for a multistate region. To support his argument, Mr. Lu offered these numbers: In the first half of 2003, China had a GDP rate of 8.2 percent and actual foreign direct investment of \$31.2 billion. Mexico, by comparison, had an economic contraction. Its foreign direct investment for the entire year of 2003 is expected to be about a third of what China reached in the first six months. "Mexico is losing a lot of business," conceded lawyer Carlos Angulo, a partner in the Ciudad Juarez office of Baker & McKenzie. "It is very rough." Mexico can make up lost ground, Mr. Angulo said. But it's going to have to cut some of its red tape, overhaul its tax system and decide in which industries it can win - airplane parts, high-tech items and those requiring a just-in-time response. Then the country needs to focus on delivering in those industries for investors, he said. One thing is certain, though, Mr. Angulo said. "Mexico doesn't aspire to have 50 cents-per-hour wages." Delphi Corp., the auto parts giant based in Troy, Mich., began operating in Mexico 25 years ago. Five years ago, the company sent its Juarez-based workers to help train their counterparts in Shanghai.

Delphi, which employs 70,000 employees in Mexico in 55 plants in 20 Mexican cities, is investing \$200 million in Mexico this year. It plans to do the same in 2004. "We have a relationship with the Mexican government, and familiarity is a good thing," said David B. Wohleen, Delphi's president of the electrical, electronics, safety and interior sector. Yet "we will weigh that advantage to some of those in developing markets," he added. "The clock is ticking." And the Asian draw is sharpening the criticism of Mexico's government. "There's no China strategy in Mexico," said Mr. Berges of Merrill Lynch. "When we talked to government officials about the issue, they say, 'What issue?'" In the meantime, at Dial Tool, Ms. Michelini said key decisions must be still made and executives should constantly be on the lookout for hidden costs when considering a China move. Hidden costs can detract from the advantages of 50-cent-an-hour wages in southern China, she said. For example, it can now cost \$1 million to set up business in a place like China's booming southern Guangdong province near Hong Kong, Ms. Michelini said. By comparison, when Ms. Michelini moved operations in 2001 to Chihuahua City, about 230 miles south of the Texas-Mexico border, the cost was \$10,000, and the factory was operating in three months. So despite the big difference in the hourly wage - about 98 cents an hour with all the labor perks in China vs. about \$2.30 an hour in Mexico - the start-up costs were much lower. This was possible because Dial Tool used a so-called shelter operation, which functions a bit like a rent-a-factory service. "Mexico is not at the rate of China, as far as labor costs, but still it is quarter or a third of the costs of the U.S., especially if you are talking about a union shop," Ms. Michelini said. "And if there is a lot of back and forth with corporate people, then it might be worth being in Mexico." Strengths A self-proclaimed "people person," Ms. Michelini worried that the machismo of Mexican men might be a problem. The first question she asks in a job interview: "Will you have problems reporting to a female?" She's effusive about her Mexican manager, who oversees a crew that performs tasks once quintessential with U.S. manufacturing muscle: welding, riveting and metal stamping. And so, Ms. Michelini said, China doesn't always beat Mexico as the country of choice for manufacturing. Dial Tool found that was cheaper to produce electrical terminal blocks in Chihuahua City, where the factory could quickly and cheaply buy the supplies it needed. In China, the parts could not be obtained according to standard industry specifications. It cost 22 cents a unit in Mexico vs. 29 cents a unit in China. But in the case of another Dial Tool product that required a lot of manual labor, it was cheaper to manufacture in China. The cost was 5 cents a unit in China vs. 15 cents a unit in Mexico. Another factor was that the buyers were in Asia.

Like Dial Tool, Electronic Product Integration Corp. is torn about moving operations from Mexico, or operating in both China and Mexico. The firm, which is based in Rochester Hills, Maine, just celebrated its first anniversary in Ciudad Juarez. Jochen Lipp, the vice president of operations for the electronics products company, is excited about the speed with which the factory can deliver to customers. As workers assembled small green circuit boards under fluorescent lights, Mr. Lipp explained that they received an order from Toshiba, the Japanese technology giant, and were able to ship 480 circuit boards within 48 hours. The electronic products company serves the auto, medical and industrial industries. Still, as pleased as the president and chief executive John Sammut is with his year-old Mexican operation, he made a trip to China last week. Like Ms.

Michelini, Mr. Sammut is finding that clients want him to bring costs down further. And China, again, may be the solution.