

MuhlenkampMethods

For the Intelligent Investor

Answers to questions you may not even know you have.

How We Benefit from Free Trade

In 1992, Ron was invited to address the Ohio Valley Chapter of the National Management Association at the Wheeling Pittsburgh Steel Corporation on the advantages of free trade. At the time, there was much debate whether or not the United States should sign the North American Free Trade Agreement (NAFTA). There was concern that such a large free-trade zone would hurt the U.S. economy. Unions feared jobs going to Mexico and Canada. Companies feared their prices would be undercut and they would lose business.

Ron's first reactions to the invitation were:

- 1. "I'm not sure I'm qualified, but then not many other people are qualified either."*
- 2. "This is a chance to explain what I believe to people like my father, who worked in a foundry (and was a member of the United Steelworkers Union) for 20 years to pay for the farm."*
- 3. "Wheeling is far enough away that the audience won't chase me all the way home if they don't like what I have to say."*

And so, Ron presented the following address on the benefits of a large free-trade zone.

When your father was your age, did he work as hard as you do? When your grandfather was your age, did he work as hard as you do? When your father was your age, did he live as well as you do? When your grandfather was your age, did he live as well as you do?

My grandfather was a farmer, which means that at my age, he farmed with horses. At my age, my father farmed with a tractor and worked in a foundry making farm equipment. Me? I sit and I think.

During my short lifetime (and you'll believe me when I say that the longer it gets, the shorter it seems), I've been very lucky. I've never had to farm with horses, but I had a neighbor who did, and I worked with him just enough to be grateful that I didn't have to. Dad bought our farm when I was seven years old. Unlike the previous farmhouse, the house had indoor plumbing, central heating, and a propane cook stove—three absolutely marvelous inventions (and except for the cook stove, all used more iron and steel than their predecessors)—but my sisters and I lost our jobs of carrying water and kindling



for the cook stove. We no longer took hot bricks to bed to keep our feet warm, and the outhouse became a backup system to handle the overflow generated by seven children and one bathroom. The barn was equipped with a vacuum pump for milking cows, and we lost that job also. Folks, your schoolbooks lie. Cows don't give milk; you have to take it from them.

The following year, when I was eight, we planted 14 acres of corn. Beginning in mid-October, each day after school I would go out and shuck corn. My mother and sisters would do the milking, and my father would join me in the field after getting off work at the foundry; we'd shuck corn until dark. It took us six weeks to shuck 14 acres. Since then, I've seen a number of boring assembly lines, but every one of them looked absolutely thrilling compared to six weeks shucking 14 acres of corn. The following year, Dad hired a neighbor with a corn picker.

But we still burned wood for heat, and we cut the wood with a crosscut saw. Dad was six-foot-four, and I was eight years old. I couldn't get into his rhythm, and he couldn't seem to understand why not. I came to love a one-man tool called the ax and let Mom have the other end of the saw. She managed both the saw and my father much better than I ever did!

The following year, he bought a buzz saw for the tractor and cut the crosscut work by about 80%. The year after that, my cousin bought a chain saw and we teamed up with him and got serious about cutting wood. It was still hard work and required every third or fourth Saturday all winter, but those metal tools removed much of the drudgery and frustration. Today, of course, I heat with gas; and believe me, it's cheap!

By now you may be starting to understand why I like machinery. A boy on a tractor is a happy boy, but this boy also loved the hay elevator because he lost a job throwing bales of hay up into a haymow. He loved the self-unloading wagon because he lost a job shoveling corn. But his all-time favorite machine, hands down—bar none—was the manure loader. Folks, my first true love was a tractor, but that tractor wasn't complete until Dad put a manure loader on it.

You may wonder why I am telling you all this. I'm telling you this partly because I'm grateful. I spent 11 years losing jobs to metal machines. I'm grateful to the people who produced that metal and those machines. As for the jobs, I don't miss a damn one of them!

But I'm also telling you this for two other reasons. The first is because it didn't have to happen, and it certainly didn't have to happen to me or in my lifetime. In parts of Eastern Europe today, my distant cousins farm with horses much as my grandfather did. In much of the rest of the world, the



people don't yet even use horses. It's not that they don't have the desire for modern machinery. It's that the machinery is not available or they don't have the means by which to obtain it.

Why did I get so lucky? I've thought about this a good bit and concluded that it boils down to two reasons:

1. We live in a (relatively) free economy; and
2. We live in a large free-trade zone.

Let me explain my reasoning. A free economy is a volunteer economy. In a free economy, the consumer is king. As a consumer, no person (or company) can make you buy his or her product.

They can advertise, pitch, cajole, promise, sweet-talk, bribe, and seduce, but they can't make you buy their product. Unless the producer makes a product you want and offers it at a price you're willing to pay, you keep your money in your pocket. Over time, most companies learn that their best sales gimmick is to provide a quality product at a cheaper price. Years ago, I was taught that there are natural monopolies, but I no longer believe that. The only monopolies I can find are government sanctioned.

The corollary to a consumer-driven free economy is that it allows a person with a good idea, a talent, or a lot of energy to profit from it. Whether you're Henry Ford, Sam Walton, Bill Cosby, or Michael Jordan, if you provide a product or service that the public is willing to pay for, you can get rich. If Steve Jobs thinks he can build a computer in his garage and call it an "Apple," no one will stop him. If I think I can serve people better on my own than by working for another company, I need only convince enough people to hire me to allow me to feed my family. In 1899, Charles H. Duell, director of the U.S. Patent Office, suggested that the office be shut down because, in his words, "Everything that can be invented has already been invented." I'm quite sure that he was an intelligent, educated man, but I am grateful that he didn't have the power to implement his suggestion or I'd be farming with a horse.

My wife Connie and I have a son, Jeff, who is serving with the U.S. Army in Germany. We recently took 10 days to visit him and his wife. We borrowed his car and took a trip around the country. At the Polish border at 7 p.m. on a Thursday evening, we saw a line of trucks three and a half miles long waiting to pass through a toll gate that was closed for the night. We saw a similar thing at the Czechoslovakian border. Somebody in those countries is deciding what goods and materials should be available to their people and doesn't mind wasting the time of a lot of truck drivers for their own convenience. Would you want someone telling you what you can or cannot buy?



My point is this: free economies are driven by the consumer. Command economies tend to focus on production and be driven by the producers. At one time, Henry Ford built most of the cars in this country. He would have been happy to continue making Model Ts, all of them black. Had he been able to get a government-sanctioned monopoly on the manufacture of automobiles, he'd have had no reason to change or improve his cars.

In Czechoslovakia today, most of the cars are Wartburgs and Trabants. These cars are about the size of a VW Rabbit and have a two-cycle engine of about 20 hp, and they also have the quality of junk. But because the people were not allowed to buy imports, the manufacturer had no reason to improve them. Someone in charge decided what the consumer should want. The consumers themselves had no vote. Therefore, there was no incentive to improve the product.

Today it seems popular to judge people by their motivation rather than by their competence and to disparage those who are deemed to be merely "greedy" in the production of goods. Personally, as a consumer, I don't care about the motivation. I don't care whether Ford built cars and tractors for money, fame, or the good of mankind; I'm just grateful that he allowed me to farm with a tractor. The point is that in a free economy, the consumer is king and the producer must serve the consumer.

But the second reason that Ford, Walton, Cosby, and Jordan have done so well is that they benefit from a large free-trade area. If Ford's market had been confined to Detroit, he wouldn't have sold so many cars or tractors, and living in Ohio, I'd have had to farm with a horse. If Cosby had been born 50 years earlier, before television, he'd be a comic in Philadelphia. If Michael Jordan had been born 30 years earlier, he'd be paid like Bill Russell was paid. Michael Jordan receives \$3 million per year playing basketball and \$15 million from endorsements. How much of that would he make if television weren't able to bring his talents into 80 million American homes and millions outside the United States as well?

If Sam Walton had to pay a tariff on all goods shipped across state lines, you and I would pay a lot more for the goods we buy. For that matter, if General Motors had to pay a 20% tariff for all out-of-state materials, how big do you think the steel business in West Virginia would be? How well would West Virginians live if your state government decided that you should be self-sufficient? How well would you live if all out-of-state goods had a 20% tariff? West Virginia is rich in coal and in good people. But so is Albania. And Albania is destitute.



I've been asked, "Who in the U.S. benefited from all of the Japanese cars we've purchased over the past 20 years, with the attendant loss of auto and steel jobs to Japan?" Well, it seems to me, the first beneficiaries were the people who bought the cars. They received better value for their money, or at least they thought so. The second beneficiaries were the people who bought American cars who got better deals because there was effective competition. The third beneficiaries are people who buy American cars today. In the United States, we now make good quality cars. If I were to buy a new car today, I'd buy American. But there isn't an American car built between 1973 and 1984 that I'd want to own, and I owned a couple of them.

But the benefits didn't stop there. The dollars we sent to Japan for cars all came back here. After all, dollars are no more useful in Japan than yen are in the United States. These dollars came back in a number of ways. Some bought airplanes: most of the aircraft being used in Japan has been built by Boeing. Some bought computer software. Some bought U.S. Treasury bonds, allowing you and I to borrow money at lower rates. Seventy-six billion dollars bought U.S. commercial real estate, right at the peak of the market. Remember the uproar in the news over the purchase by Japanese investors of Los Angeles office buildings, the Pebble Beach Golf Course, and Rockefeller Center? I saw the prospectus on Rockefeller Center; it looked to me like they paid three times what it was worth. Since then, the public price of the shares has fallen by half.

A recent article in *Pension & Investments*, dated October 26, 1992, cites an estimate by Kenneth Leventhal & Co., an L.A. accounting firm, that Japanese investors lost at least 30% of their investment, or \$22 billion in U.S. real estate, from 1986 through 1991. So we bought their Toyotas and we sold them airplanes and we sold them empty office buildings at inflated prices. It seems to me that we got the better deal!

The flip side of a consumer-driven free economy is that no one can guarantee your job unless you provide a product that the consumer wants and at a price he or she is willing to pay. Unless you deliver the goods, you and your company will be out of work.

The third reason I tell you all this is because when I look at the steel industry, I see patterns similar to what I've seen in farming. From 1860 to 1960, we took much of the heavy labor out of farming. With the help of machinery, each of my farmer cousins tills three to six times the acreage their fathers and our grandfather did. But since we haven't found five more continents, there is only room on this one for



one-fifth the farmers (in number) than we used to have. In 1860 two-thirds or 67% of American workers were farmers. It's less than 3% today. If anyone had predicted this change in 1860, some congressman would have predicted a resulting unemployment rate of 64% and introduced a bill to outlaw all machinery. Actually, he may have been right. My grandfather was never unemployed, and I doubt whether there's unemployment among the Amish. Frankly, I've always been amazed when steel workers complained about losing jobs to machines. Without machines, there wouldn't have been a steel industry in the first place.

Similarly, since World War II, we've taken much of the heavy labor out of basic industry. In the United States, we now produce the same tonnage of steel that we did in 1950, but we do it with one-fourth the man-hours. (Partly because of this, the hourly wage has nearly tripled from \$10 per hour, adjusted for inflation, to \$27 per hour.) But unlike farm products, which are consumed (literally) at a stable rate and have few substitutes, many steel products have long lifetimes and numerous substitutes. In many products, iron and steel have been replaced; in others, we're using fewer tons of higher-strength steel.

Alcoa's annual report of 1985 documents many of the great successes of aluminum. Remember when it was macho to crunch a tinsplate beer can in your hand? Now, 97% of beverage cans are made of aluminum. In 1976, the average U.S. automobile had 81 pounds of aluminum. Today it has 160 pounds. In 1985, new coal hopper cars were 85% aluminum. Despite all the rhetoric, I suspect that more U.S. steelworkers lost jobs to the aluminum industry than to the Japanese. In other areas we've satisfied the primary demand for steel. In 1980, when I asked a cousin how many farmers in Mercer County, Ohio, needed as much equipment as they had, he replied, "None." At the time, he had five tractors for two drivers. We now have as many cars and trucks in this country as we have people over the age of 18. So we don't need more cars. When I first mentioned this five years ago, my 19-year-old daughter said it couldn't be true because she didn't have one. But since then she bought a car, so now the set is complete.

And we no longer make automobiles from iron ore. We make new cars from old cars. Because the new ones are smaller, lighter, and better designed and use higher-strength steel, we can make six or seven new cars from five old ones. If you go to a county fair, you will see men of all ages wrecking cars for fun. These cars are today's raw material.



Recently I was in Wal-Mart and decided to check how many products had steel content. Other than a few hand tools and bicycles, there were none. There was, however, steel in the building and in the shelving. The consumer doesn't care what the product is made of. Connie has never sent me to the store for a pound of steel.

So, if I wanted to sell steel, I'd look to the people who want cars and appliances but don't yet have them. Frankly, Mexico comes to mind. In 1983, Caterpillar sold 12 machines in Mexico. In 1991, Caterpillar sold 1,200 machines in Mexico. In 1991, \$486 million in goods were exported from Pennsylvania to Mexico, of which \$154 million were primary materials. Also, I wouldn't worry too much about losing steel jobs to the Mexicans. Mexico wants jobs that are labor intensive. Steel is capital intensive. Last month I was told by the spokesman of a specialty steel company that many steel mills in South America are for sale and that every specialty steel mill in Europe, and some in Japan, are looking for partners. These mills were all built with government money and can't compete in today's market. In the 1950s and 1960s, emerging countries wanted their own steel mills and airlines as a matter of national pride. Countries today have different priorities.

Two weeks ago, I had a chance to meet with a delegation from Slovenia. Slovenia is about the size and population of southwestern Pennsylvania. They expressed no interest in having a steel mill or a national airline. They wanted to know how to set up their own stock exchange and a computer industry.

The Slovenians are learning what we've forgotten. We've forgotten that free markets benefit the individual consumer. We seem to have forgotten that free trade among nations makes the strength of each nation's producers available to all of their citizen consumers. Yes, it drives the producer to make ever better products at ever lower costs. Yes, it requires the retraining of workers for better jobs. But it does result in better products and better jobs.

One final point. As I said earlier, Connie and I have a son, Jeff, in the Army. Our other son, Tony, who's here today, served in the Marine Corps. With the recent "New World Order" and the downsizing in the military, Jeff called home one day and said, "Dad, things are really tough when you're in the army and have no job security." I said, "Son, I can sympathize, but not very much. As a human being if there is one organization I'd like to put out of business, it's the Army. I'm sure you'll be able to get a job doing something else."



The second group I'd like to put out of work is underground coal miners. Early this year, there was a short note in the paper that 1991 was the first year in 100 years that no one died in an underground coal mine in Pennsylvania. I appreciate their pride in the work they do and their anxiety at being trained for other trades, but I have yet to meet the coal miner who wants his son or daughter to be a coal miner.

The third job I'd like to eliminate is the job my father had sorting hot castings in a foundry. Twenty years of sorting castings exhausted his body and destroyed his lungs. No father's son should have that job.

My grandfather was a farmer; he farmed with horses. My father helped build machines and farmed with the machinery he built. I sit and I think. I cannot honestly tell you that I deserve to live a better life than they did, but I do—and I'm grateful.

Editor's Note

NAFTA was signed in 1992, forming the world's largest free-trade zone. More than 15 years later, it is viewed by many as a great success—bringing economic growth and improved standards of living for the United States, Canada, and Mexico.

As for Ron's presentation, no one chased Ron back to Pittsburgh for sharing his beliefs on free trade. In fact, the audience response was "superb."

