

Guest Commentary, by Frederick Sheehan

The Sharecropper Society

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Frederick J. Sheehan is an investor in Boston who writes about the financial markets.

"A country that is now aspiring to an 'Ownership Society' will not find happiness in – and I'll use hyperbole here for emphasis – a 'Sharecropper's Society.' But that's precisely where our trade policies, supported by Republicans and Democrats alike, are taking us."
- Warren Buffett, 2004 Berkshire Hathaway annual report

The banality of public discussion in the United States is dreadful. A reading of the *Financial Times'* February 20 edition was a reminder of our national daze. All the more so, since we don't even need to leave the front page to understand we are faced with quite a predicament.

Headline #1: "US Currency Threat to China." We read: "Washington is again seeking to increase pressure on Beijing" to revalue its currency. Threats are growing in Congress to consider legislation aimed at slowing the burgeoning trade deficit with China."

This story is so old one might question why it is isn't on page 12 except for the majority party's new found tilt at populist cant. (It is an election year.) "Charles Grassley, Republican chairman of the powerful Senate finance committee, said last week he would start to draw up legislation to deal with the growing array of US-Chinese trade problems. Grassley has grown "increasingly frustrated" and "China must live up to its commitments and responsibilities as a major beneficiary of the global trading system."

That China has benefited from global trading is without question, but from an American politician's view, the majority constituents have enjoyed a field day. If not for the Chinese (and Russian, and Japanese, and Malaysian...) governments' purchase of U.S. Treasury and home mortgage securities, Americans could not be spending \$107 for every \$100 earned. Mortgage rates would be significantly higher. It is not clear what the politicians expect to gain by this verbal barrage, other than votes. If the renimbi doubles in price against the dollar, cargo ships are not going to drop anchor in Shanghai Harbor with boatloads of American-made gym socks. This is a structural problem with much deeper roots than can be addressed through currency games.

Item #2: "White House Defends Ports Takeover Stance." Dubai Ports World (DB World) bought Peninsula & Oriental Steam Navigation Company. P&O, a 200-year-old British logistics operator, manages five ports on the east coast of the United States. Secretary of State Rice informs us the deal was thoroughly vetted for national security concerns. Another enraged Republican senator, Lindsay Graham, fulminates: "It's unbelievably tone deaf politically at this point in our history, four years after 9/11" to turn port security over to a company based in the [United Arab Emirates.]"

Graham does have a point. From a political perspective, the Democrats might question the administration's resolve in the "long war," to put it in Secretary of Defense Rumsfeld's words. In fact, Senators Clinton and Schumer are already pounding the podium. But the larger national

security problem should include the question of just what do we expect Dubai to do with our dollars. The United States is a net exporter of \$800 billion a year – and rising fast. The Middle East is working overtime to convert dollars into real, working assets. Dubai is building the world's largest airport; Saudi Arabia is constructing a \$26 billion port facility with an off-the-rack city attached. The Middle East was a trading hub for centuries. (Dubai also has constructed a 25-story ski slope, chilled under a bubble. If Mr. Market is a poet, *this* bubble popping will snowball and jolt all of the others.)

Item #3: “Dubai Spreads Wings into Aerospace.” The government will channel \$15 billion into Dubai Aerospace Enterprise. The company will “work in areas ranging from international airport development and aircraft leasing and financing to specialist aerospace education and training, aircraft maintenance, repair and overhaul, components and engine manufacturing, and assembly and aircraft final completion.”

Overambitious? Possibly, but the telecom overindulgence a few years back was great for cable installation. Most competitors went broke, but the deadbeats built enough fiber to last another generation. Money is going down the drain in the U.A.E. (A start-up oil and gas service company in Abu Dhabi tried to raise \$135 million last summer in an IPO. It was more than 800 times oversubscribed at \$110 billion.) Oil importers paid oil exporters \$300 billion last year. Dubai Aerospace will not suffer a cash flow squeeze, short of a prolonged oil glut. It may have access to cheaper lines of credit than GE aircraft leasing and Boeing. (There is a cheery side. The locals are finding construction and industrial jobs an alternative to sitting around or going West. They are welcomed in India, while entry to the U.S. and Europe grows more difficult and humiliating. Militant Islam may look as ridiculous as the Prohibitionist Party is regarded in America today. Having allotted \$500 billion to eradicate the menace in Afghanistan and Iraq, maybe our “oil addiction” will prove a superior instrument to world harmony. Then we can pin campaign ribbons to our SUVs!)

The historian Angus Maddison estimates that for 18 of the past 20 centuries, the “emerging markets” produced 80% of world output. Thanks to the steam engine and the power loom, the last two centuries have been dominated by Europe and America. In 2005, companies from the emerging markets spent \$14 billion to buy 96 U.S. companies. (The activity was more pronounced in Europe. The transfer of P&O ownership is indicative of the larger trends in commerce.) With Morgan Stanley and every other investment banking firm setting up office in the desert (under the shade of the ski bubble?), we can be sure buyouts will skyrocket.

Item #4: The front page refers us to a page 6 article: “A Russian Phoenix Struggles to Stay Free.” VSMPO-Avisma, the largest titanium producer in the world, is falling into the iron grasp of Rosoboronexport. This predator “is fast becoming a state vehicle for consolidating control” over various enterprises (e.g., automobile producers). Its state-endorsed mandate includes the trading of “strategically important raw materials.” The senators in Washington should be sympathetic to this national stand. VSMPO-Avisma supplies 30% and 60% of all the titanium consumed by Boeing and Airbus, respectively. Rosoboronexport may have every intention of satisfying Boeing's needs, although it would be difficult to name a Russian government official who has not expressed exacerbation with the U.S. dollar deluge that fuels domestic inflation. The larger problem is of U.S. dependency. That brings us to:

Item #5: “Nigerian Militants Target Oil Tankers.” Royal Dutch Shell has already reduced Nigerian oil production by 25% in the last fortnight. Nine workers have been kidnapped and general mayhem is beyond the Nigerian government's ability to control. This problem may seem remote, but the U.S. imports as much oil from Africa as from Saudi Arabia. China guards its Sudanese interests with armed troops; Angola recently terminated off-shore lease agreements with Exxon, Total and BP; Exxon is searching for an “exit strategy” in Angola; yet, expects 30% of its production to come from Africa by 2010.

This is a bad luck decade in which energy production has slowed in the U.S. and the North Sea. U.S. oil addiction played its role in the rising nationalism of countries that house appreciating resources. Just to the south, Hugo Chavez is nationalizing Venezuela's oil and gas operations. The recently commissioned president of Bolivia looks to Chavez as his role model. Petrobras, the Brazilian state-managed oil company, proposes to spend \$23 billion on a gas pipeline from

Venezuela to Argentina, thus confining Venezuelan gas distribution to Latin America. Naysayers argue it would be economic folly (as well as an ecological disaster) to build such a contraption. But Petrobras earned \$11 billion last year, and Chavez' ambitions may decide the issue. (Chavez recently shipped Venezuelan dollar reserves to the Bank of International Settlements for safekeeping.) Without Venezuelan bond buying, Brazil and Argentina could not have discarded the IMF shackles.

All in all, this looks like a good decade for dollar selling and resource buying, especially those resources that don't compete with nationalism. Washington debates the minutiae in the administration's proposed budget for the next fiscal year; spending is pegged to exceed revenues by \$500 billion (tossing in the latest \$65 billion appropriation request). This, after federal tax revenues rose by over 7% a year in 2004 and 2005. It does not appear there is a hairdo in Washington who understands the larger vulnerability to United States' national security.

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