

Beyond Phase-out of Quota in Textile and Clothing Trading:

WTO-Plus Rules and the Case of US
Safeguards against Chinese Exports in 2003

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(This version: 25 October 2003)

ABSTRACT

International trade in textile and clothing has been subject to strong protectionism for decades. Although the Agreement on Textiles and Clothing has set procedures to phase out the quota system, this paper questions how far the regime will be indeed liberalized. It highlights the significant departure of China-specific safeguard provision in its WTO accession protocol from the general WTO Agreement on Safeguard. It examines the recent case of US safeguard application against China's textile and clothing products and analyzes the potential impact of this case on both countries and the global economy. Our analysis suggests that the prospects of China's textile and clothing exports after WTO accession may not be as optimistic as popularly expected, because China-specific WTO-plus rules make it easy for developed countries to impose new quotas on China's textile and clothing products. We argue that Western countries, in particular the US, should consider the overall impact of their actions before turning to protectionism and that the world should avoid the reoccurrence of opportunistic politics induced protectionism.

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1. Introduction

For decades, the world's textile and clothing market has been subject to a special trade regime under the Multifibre Arrangement (MFA), a construct that is in conflict with the core principles of the World Trade Organization (WTO), such as non-discrimination and transparency. For about 30 years, rich countries have so protected their domestic textile industries from the cheaper imports originating in poorer nations.

Not until January 1995 did the WTO Agreement on Textiles and Clothing (ATC) come into force, which attempted to reverse decades of trade protection in these sectors. The ATC sets out the framework and procedures to phase out the MFA and eliminate the entire quota system eventually by 2005. This should have a huge positive impact on developing countries, which have been restricted on exporting their textile products for such an extended period of time. China, as the largest textile and clothing exporter of the world, would face a tremendous trade opportunity thanks to its entry to the WTO in 2001.

However, newly released safeguard measures by the US against China's textile exports, which took effect on May 21, 2003, have led to renewed worries. Can China be optimistic and hope for a better, more unrestricted future for its textile and clothing trade, or will there be ever new barriers to trade for the world's largest textile exporter, which will replace the existing ones that are being dismantled? Is the phase-out of quota the end of other countries' protection mechanisms against China's exports, or is a new set of restraints already waiting in those countries' trade departments' drawers? What would be the likely effect on China as well as the international trade regime if the US and other major developed countries implemented new safeguard actions, which may have different forms from, but as tough as, the ones existing at present? There is great possibility that China's full integration into the WTO could be effectively held up, because China's WTO accession agreement includes a unique, China-specific safeguard mechanism allowing a WTO member to restrain increasing imports from China if that disrupt its home market. This is widely regarded as a "wild card" against Chinese imports and a powerful example of possible measures that could be taken in future to erect new trade barriers against China.

This paper addresses this issue by focusing on the textile safeguard provisions specified in China's WTO accession protocol. The rest of the paper is organized as follows. Section 2 provides a historical overview on the evolution of protection regimes in textiles and clothing trade. Section 3 summarizes the popularly expected gains that China's textile and clothing industry may enjoy after the phase-out of the quota. We argue that it is these widely expected gains which may be perceived as a threat by some powerful interest groups in industrialized countries and may induce them to take protectionist actions and restrict imports from China. Section 4 compares the China-specific safeguard provisions with the general WTO Agreement on Safeguard. The comparison indicates that the China-specific WTO-plus rules are discriminatory and are very likely to be utilized by potential importing countries because the conditions for adopting safeguard measures against China are easy to be met. Section 5 analyzes the case of recent American safeguard actions against China's textile and clothing export. Both US and Chinese perspectives are examined and compared. The sequential impacts on both countries and the global economy are

assessed. This case may serve as an illustrative example of what the China-specific safeguard measures mean for China's future international trade. Finally Section 6 discusses policy suggestions and warnings and raises some concluding remarks.

2. Historical Evolution of Protectionism in International Textile and Clothing Trade

2.1. THE ANALYTICAL PRISM

In economics theory, the perfect market economy should allow each firm, each region and each country to produce what they are best at and to exchange their product for the goods and services of others.¹ People and nations benefit from expanding trade, a result from increased economies of scale, a greater division of labor, and more efficient allocations of investment. Thanks to trade, both labor and capital can easily find the sectors and regions where they add most incremental value. Under the current global trading system, many jobs in clothing and other industries are moving from developed countries to developing ones, where wages are lower and land is cheap. In exchange, developed countries receive cheap consumer goods and also get access to expanding markets for their higher value-added goods and services. Theory suggests that free trade is largely a process where both sides gain. In practice, however, trade has always been a messy affair, in which political considerations – both domestic and international ones – often have influence over policies and economics. Typically countries try to support failing domestic industries, instead of focusing on their areas of greatest strength, where the competitive advantages lie.

Economists often feel puzzled in explaining protectionism. If in theory free trade improves economic efficiency, why is it that in the real world free trade is the exception rather than the norm? Why do those countries that helped to build up the global trade systems aiming to promote free trade among nations and where often are home to the most eminent economists seem to ignore too often the benefits of free trade? The answer lies deeper. It lies in the heterogeneous interest structure across groups within the national border. In other words, if we assume that most individuals and groups are most interested in their own costs and benefits considerations rather than in those for their country or the world, it becomes consistent and logical why people often favor, on a nationwide scale, inefficient trade protection for their respective industries (Rothbard, 1986).

Taking the textile and clothing industries as an example, it is often stated by their representative lobby groups that those industries face disasters due to cheap import and no-one should accept that one of their major industries be extinguished because “no country can derive its entire economic strength from the technologically advanced industries alone”. A further argument is that failure to take account of the interests of the textile and clothing sectors will inevitably cause “a large portion of the textile community's labor force into permanent unemployment” (Keesing and Wolf, 1980). Moreover, low wages in developing countries are often seen by the protectionist camp as an “unfair” basis for competition. One common argument is that “it is unfair for an American firm to compete with,” say, “a Taiwanese firm

¹ One of the prime examples for trade based on absolute cost advantages is Adam Smith's description of trade between England and Portugal, where English cloth was traded against Portuguese wine. Later theories include early 19th century scholar Ricardo, who introduced comparative cost advantage considerations as reasons for trade.

which needs to pay only one-half the wages of the American competitor." Therefore, the government should step in and "equalize" the wage rates by imposing an equivalent tariff upon the Taiwanese (Rothbard, 1986).

On top of the arguments raised above, national security consideration often comes. The trade of certain commodities may be economically beneficial but harmful to the country's national security at one point. In this connection, trade of weapons tends to be strictly regulated. This consideration also applies to high-tech goods such as super computers or telecommunication equipment because those could be used to build high-tech weapons or for espionage purposes. To the extreme if a specific country is considered by another country as a strategic challenger to its own position, trade of a wide range of goods or services could be seen as harmful to national security – helping to build up the rival's future adversary.

2.2. FROM LTA TO MFA

Trade protection in the textile and clothing sectors has a long history (Raffaelli and Jenkins, 1995). Quantitative restrictions on textiles and clothing trade started as early as in the 1930s, when the US negotiated a voluntary export restraint (VER) on Japanese textile exports. In response to protectionist pressures in the US in the late 1950s, Japan, Hong Kong, India, and Pakistan agreed to "voluntary" export restraints for cotton textile products. At a GATT meeting in 1959, the US brought up the problem of "market disruption due to sudden large increases of imports from low-wage countries". This concept of "market disruption" quickly became the key rationale behind future safeguard measures. In 1961, the newly-elected President John F. Kennedy announced a new program of assistance to the textile industry in the US, which resulted in a Short Term Arrangement (STA) in cotton textiles, allowing temporary restrictions in face of market disruption for one year, pending negotiation of a longer-term arrangement. The Long Term Arrangement Regarding International Trade in Cotton Textiles (LTA) was then reached in 1962. It imposed a five per cent annual growth cap on imports of cotton textile products for a five-year period, and doing so violated various GATT principles (Keesing and Wolf, 1980).

The LTA has effectively protected the cotton industry in developed countries. However, the LTA only covers cotton products or products containing over 50 percent cotton. Facing the fast-growing imports of textile products not covered by the LTA, mainly man-made fiber textiles and clothing from Japan, Taiwan, South Korea and Hong Kong, the US reacted quickly by requiring these countries to negotiate separate bilateral quota agreement that set limits to their exports of products made from man-made fibers and wool. At US insistence and with US leadership, as in the case of the LTA, the Multi-fiber Arrangement (MFA) went into effect on 1 January 1974. It provided a framework of VERs that regulated textiles and clothing exports from most developing economies entering almost all major industrial markets. Restricted textiles and clothing imports were limited to an annual growth rate of six per cent. The MFA had been re-negotiated and sustained for more than two decades and covered more than 50 percent of world exports of textiles and clothing. Consequently, the world trade in textile and clothing of cotton, wool and synthetic fibers had been subject to this special regime until 1995 when the ATC came into effect. The various versions of the MFA had been in conflict with the basic principles of the GATT and later on the WTO.

2.3. THE AGREEMENT ON TEXTILES AND CLOTHING

The Agreement on Textiles and Clothing (ATC) is one of the most significant outcomes of the Uruguay Round trade talks, finally addressing developing countries' concerns, as the ATC was designed to facilitate "the integration of the textiles and clothing sector into GATT 1994" (Reinert, 2000). As shown in Table 1, under the ATC, bilateral quotas under the MFA will be enlarged in three stages and fully integrated by January 2005. In the first stage, the growth rates of quota volumes will increase by 16 percent. In the second stage, the growth rates will be further increased by 25 percent. In the last stage, the growth rates will be raised by 27 percent.

TABLE 1: THE TEN-YEAR SCHEDULE FOR INTEGRATING TEXTILE TRADE INTO GATT RULES, IN PERCENTAGE

Stage	Integration share (based on 1990 import volume) ^a	Expansion of growth rate for remaining quotas
Stage 1: 1 Jan, 1995	16 (total: 16)	16 (e.g. from 3% to 3.48%)
Stage 2: 1 Jan, 1998	17 (total 33)	25 (e.g. from 3.48% to 4.35%)
Stage 3: 1 Jan, 2002	18 (total 55)	27 (e.g. from 4.35% to 5.52%)
Stage 4: 1 Jan, 2005	45 (total 100)	Full integration

Note: ^a Importing countries are free to choose the products that they integrate at each stage, as long as products are included from the four groupings of tops and yarn, fabrics, made-up textile products, and clothing.

Source: WTO [<http://www.wto.org>].

Compared to the MFA, the ATC did promise to deliver a significant amount of liberalization during the 1995 to 2004 transition period. However, some trade policy analysts also expressed their doubts about the truly liberalizing nature of the ATC commitment. As questioned by Reinert (2000), a number of points are worth noting here. First, integration is in terms of volume, not value, and Stage 1 and 2 integrations were concentrated in low-value-added products (Textile Monitoring Body, 1997). Second, integrated items must fall in either one of the following four categories: top and yarns, fabrics, made-up textile products, and clothing. Nevertheless, Stage 1 and 2 integration was skewed away from clothing. Taking Stage 1 and 2 together, the share of clothing in the integrated items was only 12, 11, 8 and 7 per cent, respectively, for the United States, Norway, Canada and the European Community (Textiles Monitoring Body, 1997). Third, importing countries expanded the Annex during negotiations to include many items never originally subject to the MFA.² Consequently, Stage 1 integration contained actually only one item, work gloves exported to Canada, previously subject to quantitative restrictions (Textiles Monitoring Body, 1997). Stage 2 included more restricted items but still reflected the expanded Annex. Lastly, it is notable that nearly one half of the liberalization is scheduled to occur on January 1, 2005. Because the ATC empowers the protected countries to determine which items are to be liberalized in which stages, it is very likely that the most politically sensitive items will be included in the last stage. As pointed out by Baughman *et al.* (1997), "at the present time, it is unclear whether the

² As stated by Bagchi (1994), "the purpose of this fiction was apparently to inflate the volume of total imports in such a manner that the restricting countries could fulfill their obligations for integration without removing the existing MFA restriction."

ATC will succeed. Major importers have been able to defer the most difficult liberalization (for clothing). In the case of the US, clothing has been put off to the very end of the ten-year transition period.”

Another notable issue in the ATC is safeguard provisions. Some authors (e.g., Spinanger, 1995; Baughman et al., 1997) have published pessimistic opinions about the ATC, concluding that importing countries might renege on their commitments altogether, as safeguard measures make it possible for those countries to take actions against import if and when they want. For example, the 1997 bilateral textile agreement between China and the United States also includes a safeguard provision, which is founded on the ATC. The agreement under which China gained membership of the WTO included a special textile provision that can be used by other members until the end of 2008 against all products subject to the ATC. The WTO agreement also included a China-specific safeguard, effective until 2013, allowing other members to take action against any import from China that causes market disruption. This special textile provision in particular is tailored towards China as a major exporter and is strongly discriminatory in nature. Section 4 will further examine this issue.

3. Popular Expectations on China’s Gains in the Textile and Clothing Sector after the Phase-out of the Quota

There has been a large body of literature analyzing the impacts of China’s WTO entry on its domestic economic sectors (e.g., among others, Development Research Center of the State Council, 2000; Yu and Zheng, 2000; Ianchovichina and Martin, 2001). It is widely accepted that China’s agriculture and certain capital-intensive industries will face tremendous international competition, which will result in rising unemployment in these sectors. On the other hand, one area, in which China has a real opportunity to expand output and exports, and thus employment, is labor intensive manufacturing. Textiles and particularly apparel are two industries that have the greatest potential to generate jobs and thus not only crucially offset job losses elsewhere in the economy, but also support China’s future ability to generate foreign exchange earnings through exports.

As well summarized in Lardy (2002), even before becoming a WTO member, China’s exports of textiles and apparel were growing rapidly. Despite the fact that it had been under strict quota restrictions imposed by many important foreign markets, Chinese textile exports rose five-fold from US\$ 2.5 billion in 1980 to US\$13 billion in 1998. Apparel exports soared from a mere US\$ 1.5 billion in 1980 to US\$ 27 billion in 1998. Between 1980 and 1998 China’s world market share of apparel more than doubled and reached 15 percent in 1998. At its accession to the WTO, China already was the world’s largest producer and exporter of textile and apparel products, with US\$ 16 billion (10 percent) and \$36 billion (18 percent) in world exports of textiles and clothing, respectively, in 2000 (*International Trade Statistics*, 2001).

This growth, however, could have been even more rapid if there had been no quota restriction imposed by the US and other industrial countries. A comparison of the growth of exports of textiles and apparel with other labor-intensive products, such as footwear, makes the ATC’s restrictive role apparent. From \$173 million in 1980, footwear exports grew almost fifty-fold to \$8.4 billion in 1998. It is because footwear exports were restricted by only very few importing countries. Under the 1997 bilateral US–China agreement on textiles, the US imposed quotas on 101 sepa-

rate product categories. These quotas made the import prices of Chinese textiles and apparel in the US market 11 and 37 percent higher than those in a quota-free environment (U.S. International Trade Commission, 1999). This bilateral agreement also limited the growth of quotas for those products that the US considered most important to only 1 percent per year. China filled most of these quotas by 95 to 100 percent, clearly indicating that the quota successfully restricted the growth of textiles and apparel exports to the US (Lardy, 2002).

From the date of China's WTO accession onward, the China-US bilateral textile agreement ceased to operate and the China-US textile trade will now be governed by the ATC. According to Table 1 above, the quotas on China's textile and clothing exports have increased by 25 percent by 2001, and by a further 27% starting from 2002. At this rate, China should be able to increase its textile exports by roughly US\$ 50 million a year. Under the ATC, the US had also pledged to remove quotas on China's exports of certain types of textile products, such as baby clothing, knitted fabrics, gloves, trousers, coats, jackets and skirts by 2002.

A scenario analysis conducted by the Development Research Center of China's State Council (2000) suggests that China's world market share of textile and clothing products will rise by about 1 percentage point while quotas are being phased out; then jump by about 4 percentage points in 2005; finally, it will rise gradually over the rest of the decade. For clothing alone, China is expected to gain additional 10 percentage points of the world export market by 2010. According to other analysts, this estimation is even undervalued. For example, the US International Trade Commission (1999) estimates that China's share of the world apparel market will jump by about 6 percentage points in 2005. Ianchovichina et al (2001) suggest that the same share may be able to jump one-quarter and reach 45 percent of world exports by 2005-06. Foreign firms will play an important role in the development, as a significant share of apparel exports are produced under processing contracts with foreign firms, and these firms are gearing up to shift additional production to China in anticipation of the phase-out of all quotas in 2004. Hong Kong firms, which supplied 5.4 percent of the apparel world market at the end of the 1990s,³ are also motivated to shift their production to China because of their geographic proximity and comparatively high local production costs.

In contrast to apparel exports, China's share of world textile exports is not likely to increase significantly because the latter is not as labor-intensive as apparel production. Moreover, China may even become a large net importer of textile raw materials, due to the great demand resulting from producing apparel. It is predicted that by 2010 China will be a net importer of one-sixth of all textile products sold on world markets, in order to be able to supply more than two-fifths of the world market in apparel (Ianchovichina et al., 2000). The Development Research Center (2000) suggests that employment in the apparel and textile industries could be 28 percent and 8 percent higher, respectively, by 2010, as a result of China's entry into the WTO, implying a creation of 5.4 million new jobs.

All above predictions were supported by the development in 2002, the first year following China's entry into the WTO. Despite a sluggish global economy, the export value of textiles and clothing in the first half of this year amounted to US\$ 27 billion, 7% up on an annual comparable base ("Chamber Highlights", *Textile Trade*

³ This number is for exports of apparel produced in Hong Kong. It excludes Chinese apparel re-exported from Hong Kong (International Trade Statistics, 1999, pp.122, 132).

Express, no. 11, 2003, p.3). Besides the prediction on export growth, it is also widely expected that integration into the WTO will help China's textile industry to upgrade its technology, management, and trading systems.

Nevertheless, there is no projection that pays attention to the possible emergence of new protection quotas or other measures that can be adopted by other WTO members under the China-specific textile safeguard and other WTO-plus rules. In the case where other WTO members make extensive use of the already-mentioned China-specific textile safeguard and other provisions to protect their respective domestic industries, the existing prediction of large increases in output, export, and employment in China's textile and apparel industries will unlikely become materialized. The following two sections will highlight the seriousness of this issue.

4. The Departure of China-specific Safeguard from the WTO Safeguard Standards

In WTO principles, safeguard measures refer to *emergency* import restrictions applied under the WTO Agreement on Safeguards and GATT Article XIX. They are supposed to be applied to prevent or remedy *serious* injury to domestic industries caused by rapid increases in imports. WTO Agreement on Safeguards Article 2 lays out strict conditions for the application of safeguard measures. It is because safeguard measures interfere with legitimate trade through unilateral restrictions on imports and their abuse can lead to a destabilization of the world trading system. In other words, unlike anti-dumping actions and countervailing duties, safeguard measures are applicable regardless of the existence of any unfair trade practices on the part of exporters. Therefore safeguards should be regarded as a measure of last resort and the conditions that must be fulfilled before a country can impose import quotas are usually rather rigorous (Lee, 2002). However, the safeguard provisions that China was pressed to accept in WTO accession negotiations are more onerous and discriminatory for China than those accepted by any other member of the WTO. Following these provisions it will be fairly easy, by the usual safeguard standards, for the US or other importing countries to invoke particular protection measures. To show how significant the departure is, in this section we compare the China-specific transitional safeguard measures and the special textile safeguard with the general WTO Agreement on Safeguards.

4.1. WTO AGREEMENT ON SAFEGUARDS

The major features of safeguards under the WTO Agreement can be summarized as follows (Lardy, 2002; Lee, 2002; Qin, 2003). First, under the WTO Agreement on Safeguards, a causal link must be demonstrated between the increased import quantities and the "serious damage, or actual threat thereof", if a country wants to impose the restriction. More rigorously, the coincidence of increased imports and declining sales, employment, and profits of domestic producers is not a sufficient link. Even showing a causal link alone is not sufficient for adopting safeguard measures; it must also be demonstrated that the increased level of imports is at least as devastating to the domestic industry as any other cause.

Second, except under special circumstances, safeguards must be applied on a most-favored-nation basis, i.e. proportionately on all suppliers. Thus, a restriction imposed under the WTO general safeguard provision cannot be imposed solely on goods originating in one specific country.

Third, the WTO Agreement requires transparency. A safeguard measure normally cannot be taken until after the relevant governmental authority has conducted an investigation to determine whether serious injury or the threat of serious injury to the domestic industry exists. Reasonable public notice must be given to all interested parties, including importers and exporters, who should have an opportunity to present their views. The findings and conclusions of the investigation must be made public.

Fourth, if the safeguards action is taken in the form of using quota to control imports, the quota cannot be set so low that it would reduce total imports of a good below the average level over the prior three years. The quota quantity must also be increased each year once it is imposed. If a safeguard has been used for more than four years, these conditions are even more stringent than before and under no circumstances can a safeguard measure be imposed for more than eight years.

Finally, under certain conditions, the exporting country has a right to retaliate. The country imposing a safeguard may offer exporting countries compensation for the restriction of their exports. If no compensation is offered, the importing country may withdraw substantially equivalent concession to the country invoking safeguard measures. But if imports have indeed increased absolutely, the exporting countries may withdraw substantially equivalent trade concession only if the restrictions remain in effect for more than three years. If imports have only increased relative to domestic production, i.e. have not increased by an absolute amount, the exporting countries may withdraw substantially equivalent concessions immediately.

4.2. THE CHINA-SPECIFIC SAFEGUARD CONDITIONS

In contrast to the above mentioned general safeguard rules, the transitional product-specific safeguard clause and the rules governing the China-specific textile safeguard in China's protocol of accession to the WTO are much less stringent (WTO, 2001a, Section 16; WTO, 2001b), and thus are much easier to satisfy and impose against Chinese exports. The major reasons are as follows.

First, the injury standard in the transitional product specific safeguard is lower, which can be met by only the mere existence or the threat of market disruption, rather than actual serious injury. Market disruption in the US trade law is defined to exist whenever imports are increasing rapidly, either absolutely or relatively so as to "be a significant cause of material injury, or threat of material injury to the domestic industry." Thus, the US (and similarly other WTO members) can act based on the lowest showing of injury. As US Trade Representative Charlene Barshefsky confirmed in the Hearings before the Senate Committee on Finance (Feb. 23, 2000, see, www.finance.senate.gov/W2-23-0), the transitional product-specific safeguard "permit us to act based on the lowest showing of injury".

Second, WTO members may impose restrictions solely against goods originating in China, even when imports of the same product from other countries have increased. This is a major exception to the principle of non-discrimination that is at the core of WTO rules of conduct.

Third, the transparency requirements of transitional product-specific safeguards are less demanding. Instead of an investigation conducted by the government, the importing country government can directly request for consultations with the Chinese government. If the Chinese government agrees that its exports have caused or threatened to cause market disruption, it may voluntarily restrain exports. This

action is again contrary to the Safeguards Agreement, which prohibits voluntary restraint agreements. If the Chinese government does not agree to take such action to prevent or remedy the market disruption, other members must provide reasonable notice and allow interested parties to rebut their views. Sixty days after the initial request for consultations the country may unilaterally impose restriction on imports from China. This is to say that either China should restrain its exports voluntarily or the importing country can impose quota or increase tariffs unilaterally.

Fourth, China's ability to retaliate is more restricted. If the safeguard action is based on a relative increase in imports, China will have to wait for two years until it can withdraw equivalent concessions. While the WTO Agreement on Safeguards allows for a maximum of eight years for safeguard measures, the transitional product-specific safeguard may be applied to imports from China as long as necessary, i.e. has no specific time limit at all. Once a restrictive quota has been imposed against Chinese imports, there is also no requirement to increase the quota quantity over time. As China has agreed to allow WTO members to apply the terms of transitional product-specific safeguard for a period of twelve years from the time of its accession, this means once a restriction is imposed, it could exist until 2013.

Finally, the transitional product-specific safeguard contains an unusual special provision: market disruption as a result of trade diversion. The argument for this special provision is that after one country imposes safeguards on China, diversion could arise if Chinese firms redirected their exports of that product to other markets where no safeguard is in effect. In this case, other members may request consultation with China if they anticipated an increase of imports from China in their countries due to the safeguard measures in other markets. If China cannot make decisions within thirty days to restrict its exports, those countries may impose restrictions unilaterally sixty days after the initial request for consultation. There is no requirement for any investigation to determine whether the trade diversion has indeed caused market disruption in other countries. Thus it is very likely that safeguard actions against China start in one country and quickly cascade to all other significant markets.

Besides this transitional product-specific safeguard, China also agreed to accept another rather discriminatory measure, the so-called "special textile safeguard". The latter, which can be utilized until Dec. 31, 2008, if fully implemented, would allow the WTO members to limit the growth of Chinese textile and apparel imports to 7.5 percent per year (WTO, 2001a, Section 16; 2001b, para. 242). As with the transitional product-specific safeguard, the conditions under this special textile safeguard are, too, relatively easy for importing country to meet. Market disruption, no matter whether it exists or just poses a threat, is defined as imports that are increasing rapidly, absolutely or relatively. Restrictions can be imposed even when total imports are not growing, but products from China are displacing those of other suppliers. Moreover, China cannot retaliate even when imports from China have only increased relatively. The restriction on China's textile and apparel imports can automatically take effect immediately without being consulted with China. This again breaks the usual procedures in which consultation is required and if the consultation comes to no result the case can be postponed for one year.

In brief, the special textile safeguard makes it possible and easy for importing countries to impose quotas on China's textile and clothing products until end of 2008, although according to the ATC they are supposed to phase out the quota in four steps by 2005. Countries that previously had not maintained quotas on Chinese

textiles and apparel products under ATC now also have the right to impose these safeguards. An unclear issue is whether transitional product-specific safeguards can also be applied to textile products. If yes, when special textile safeguards cease to exist at the beginning of 2009, transitional product-specific safeguards could take their place to allow the importing country to maintain their restrictions until 2013.

By comparing the terms of China-specific safeguards provisions with those under the WTO Safeguard Agreement, it becomes clear that both transitional product-specific safeguards and special textile safeguards are discriminatory and designed towards developed countries' benefits. The recent case of US safeguard action against China's three categories of apparel imports, to be discussed in the next section, may signify the beginning of the utilization of such "wild cards" provided by the China-specific safeguard provisions.

5. The Recent Case of US Safeguard Action

5.1. THE INITIATION OF THE CASE

On 21 May 2003, the Committee for the Implementation of Textile Agreements (CITA) published a notice in the Federal Register. The notice outlines the procedures for employing the special textile safeguard provision contained in China's WTO accession protocol and the *Report of the Working Party on the Accession of China* (see, http://otexa.ita.doc.gov/Safeguard_procedures.pdf). These safeguard measures took effect immediately on the same day. Quickly following the notice, the American Textile Manufacturers Institute (ATMI) together with other five industry associations intensified their coordinated lobbying campaign. On July 24, ATMI together with other three associations formally filed four joint petitions with the US government, which was by large a resubmission of their September 2002 petitions. The petitions ask that quotas be re-imposed on surging imports of four categories of Chinese textile products: knit fabrics, dressing gowns, brassieres and gloves (see, www.atmi.org/Newsroom/jointpetition.pdf). A report release by the group claims that the imports of these four categories have increased by 920 percent between January 2002 and May 2003 (ATMI, 2003a). On August 18, CITA announced in Federal Register that it formally accepted for further consideration three of the four China textile safeguard petitions. On the same day CITA posted the three petitions and initiated a public comment period lasting until September 17, 2003 (see, <http://otexa.ita.doc.gov/fr.htm>).

Under the safeguard procedure, CITA has 15 business days to make sure the petition is acceptable. Once the petition is accepted, it will be posted for a 30-day public comment. CITA will then have 60 days to determine whether consultations with China should be requested. Should CITA decide to request consultations, it will announce this decision in the Federal Register. The new quota will come into force on the publication date of the Federal Register notice. China immediately would have to hold its shipments in the categories at issue to a level of 7.5 percent above the imports entered over the past twelve-month period. Should the US and China fail to resolve the issue in the consultations, the quota would become "permanent", as described before in Section 4.2. Therefore, in a worst-case scenario, the new quota on these three categories will be in effect from the end of November 2003 until December 31, 2008.

5.2. THE REASONING FOR THE CASE: THE US PERSPECTIVE

To demonstrate how big a threat the US textile industry is currently facing from China, ATMI has published a series of reports and presentations (see, www.atmi.org). According to one of their recent statements, the crisis in the US textile industry entered its third year in 2003 as imports from China and Vietnam in quota-released categories jumped by hundreds of percents while US textile employment and shipments continued to slump. Since 1997, the US textile industry has been forced to close more than 250 domestic textile plants, including more than 50 textile plants during the last year and a half. Over 200,000 US textile workers have lost their jobs, including more than 30,000 since January 2002. Five of the country's largest modern textile mills – Pillowtex, Burlington Industries, CMI Industries, Galey & Lord, and Malden Mills – have filed for bankruptcy (ATMI, 2003b).

According to ATMI (2003a), American manufacturers have been alarmed by the speed of China's domination in all the categories for which quotas were lifted in January 2002. Within 17 months, China's overall share in the liberalized 29 categories surged from 9 percent to 45 percent. In 2002, China exported US\$63 billion of textiles and clothing to the US. The 3.6 billion square meter increase from China since 2001 was the largest increase in imports from any country in US history and 96 percent of the increase was in quota de-controlled categories.⁴ In 2001 China was the 4th largest exporter of textile products to the US. By the first quarter of 2003, China became the largest exporter, being 50 percent larger a player than its next closest competitor, Mexico. It is estimated that China's market share in the 29 categories could reach 70 percent by the end of 2003, because of prices being cut by an average of 46 percent after elimination of quotas. The report further suggest that if China follows the same pattern in 2005, when the bulk of its quota will be removed, then its share of the US textile and apparel market will rise to over two-thirds of the market within 24 months. Total job losses from 2004-06 in the US textile and apparel sector could reach 630,000, with over 1,300 plants closing in the sector over a three-year period.

China's textile exports have also been repeatedly blamed by the US in the past as the result of unfair trade practice. One of the most prominent arguments in this context is that China has manipulated its currency to boost exports unfairly. Since the mid-1990s, China's Yuan has been pegged to the US dollar at a fixed exchange rate of 8.28 Yuan per Dollar. During the 1997 Asian financial crisis, the US and other countries applauded China for keeping the currency stable when the currencies of other Asian countries fell rapidly in value, making their exports cheaper. But now China has come under attack for refusing to let the value of its currency change in response to market forces, making its exports unfairly cheap. Many economists estimate that the Yuan is undervalued by 15-20 percent. The Manufacturers Alliance (2002) claims that Chinese yuan is undervalued by 40 percent, which creates unfair competitive advantage for China.

5.3. COUNTER ARGUMENTS: THE CHINESE PERSPECTIVE

What is China's response to those safeguard measures? As reported in Chinese official newspaper *People's Daily* (April 24, and May 27, 2003), in anticipation of the forthcoming safeguard case, the Chinese Textile Manufacture Institute (CTMI) has made a strong statement that American safeguard measures are a wrongful decision and will hurt the benefit of both nations in terms of bilateral trade as well as the

⁴ Textiles quotas are typically expressed in million square meters of fabric.

both nations' economies. First, the four categories of goods that were filed for in the above-mentioned petitions are not produced in America in meaningful quantities, thus the US' claim that these four categories impose a threat on comparable products made by American domestic companies is not substantiated.

Second, CTMI argues that the rapid increase in China's exports of textile and apparel products to the US in 2002 reflects the progress of the technical level and improvement of productivity in the industries. Growth is also attributed to the increasing amount of Chinese subsidiaries of Western multinationals and joint venture partners who are searching for profit opportunities in anticipation of an ever more liberalized business environment after China's WTO accession. Hence, foreign direct investment from the developed world is to be made responsible for a substantial part of increased exports, due to the fact that China is assuming a more important role in the global supply chain as a place where Western companies out-source labor-intensive processes to.

In response to the currency issue, CTMI argues that China's currency has been pegged to the US Dollar since 1994 without change. This means there have been no currency-induced shifts in relative prices that can explain the emergence of the massive US-China trade deficit.

5.4. AN INDEPENDENT ASSESSMENT: US-CHINA TRADE AND THE SAFEGUARD CASE

This subsection presents an independent assessment of the debate on US-China trade in general and the safeguard case in particular, which is largely based on existing scholarly works in the US press.

First, the increase in US textile and apparel imports from China is mostly at the expense of other countries' imports. For example, the estimation of the China-WTO global general equilibrium model run by the US International Trade Commission (USITC, 1999; <http://dataweb.usitc.gov>) suggests that China's WTO accession would induce a fall of the combined US market share of apparel producers in Hong Kong, Taiwan and South Korea by 2 or 3 percentage points, a similar fall of that of other restricted suppliers, and a large fall of that of other unrestricted suppliers by about 15 percentage points. Mexico, which exported 40 percent more apparel to the US than China did in 2000, will lose its number one position to China. This simulation clearly indicates that China's significant gain in the US market shares of textile and apparel does not mean that the total imports of US textile and apparel products will also increase, it is largely a competition across major exporters for a given market. Furthermore the simulation does not suggest that China's gain in the market share would cause significant increase in US unemployment in the textile and apparel sectors.

In fact, the American unemployment problem in the textile and apparel sectors has started since Mexico's exports to the US soared under the North American Free Trade Agreement (NAFTA). By July 2001, employment in apparel production had fallen by 400,000 people compared with December 1993, immediately before NAFTA took effect. From the beginning of NAFTA through July 2001, the average annual reduction in employment in the apparel industry in the US was 53,000 employees, which is more than five times the annual job losses in the three years before NAFTA (Lardy, 2002; www.bls.gov). In this connection, 30,000 lost jobs in 2002 can be also regarded as the continuation of this trend and with a significant reduction on the scale. It is difficult to directly and fully attach this 30,000 job losses to the increased apparel imports from China. The above assessment indicates that although imports

of apparel from China may surge as quotas are removed, much of this increase would just reflect a displacement of Mexican apparel and would have, if any, a modest effect on US employment compared with the abrupt decline since 1994.

In brief, the existing scholarly works in general do not suggest a causal link between an increased quantity of Chinese textile and apparel imports and serious “injury” caused by this in the US. However, under the China-special textile safeguard, what matters is not whether there is serious injury to the domestic industry but material injury or just the threat of it. This comparatively low hurdle makes it quite easier for the US to take action against China, even if this action clearly departs from the general WTO principle and is going to damage the overall gain in US GDP and social welfare.⁵

As we discussed in Section 2.1, international trade can never be entirely free of political influence. A political economy analysis may help to understand what could be a political motivation for this safeguard action? The upcoming US presidential election campaign could play an important role in this case. As the above-mentioned report from ATMI has stated, the textile sector remains one of the largest manufacturing employers in the US. It used to be the third-biggest manufacturing industry and employed 1.7 million workers in 1995. As of present, it still employs nearly one million people (Hagstrom, 2003). This industry is mainly concentrated in the South of the US and it commands a strong local political lobby. As a result of the globalization and the shift of the labor-intensive industries from developed countries into developing countries, many textile and apparel plants are forced to close and jobs are being cut. Those laid-off people across the South, who would be rather displeased, will be voters in the 2004 presidential elections. The current administration, as a result, is expected to show more support to this area, as “there are several congressional seats and a Senate seat or two that are in danger if nothing is done to protect those workers”.⁶

Another factor at play may be the sluggishness of the US economy since the Bush administration took over power. The US global trade deficit reached a historical record of US\$ 435 billion in 2001 and further to US\$ 482 billion in 2002. China’s trade surplus with the US exceeded US\$ 100 billion and topped the list of countries that have a trade surplus with Washington for the first time in 2002 (*China Daily*, July 11, 2003). Consequently, the current administration has been accused by labor leaders of trading away American jobs to win China’s support for the war on terrorism and for the campaign to end North Korea’s nuclear weapons programs. Under these circumstances, trade with China could be considered an easy target by the US government that can be hit in order to alleviate some of the pressure from influential domestic interest groups who were among the losers of recent economic developments.

5.5. IMPACT ASSESSMENT

If the safeguard measures were to be put into effect, first and for most China could suffer great losses. China exports about 40 per cent of its textile and apparel production. Among apparel alone, more than 50 percent of Chinese-made products are manufactured for export. Tough actions of the US would certainly encourage other countries to follow suit, as indicated by the quick imitative moves of India and EU

⁵ The China-WTO model of the USITC (1999) suggests that following China’s WTO accession the overall gains of US GDP and household welfare are US\$ 1.7 and 3.3 billion, respectively.

⁶ This is cited from a news conference speech given by Jim Chestmett, President of the American Yarn Spinner Association of North Carolina on June 10, 2003 (*Congress Daily*, Jun 11, 2003).

to start their safeguard probe on China (*China Daily*, July 31, 2003). Tough new restrictions from the major markets would certainly eliminate the popularly expected gains of China's WTO accession in the textile and apparel sectors (Section 3). In addition China has its own national unemployment problem. The nation's textile and apparel industries are top providers of non-agricultural jobs, the Development Research Center's (2000) modeling work suggests that a drop of output in the industries by 1 percent would eliminate about 72,000 jobs.

Second, US consumers and trading companies will be hurt by higher clothing prices. Taking the example of ladies' hand-knitted wool sweaters from China, Table 2 shows how quotas increase prices. The United States limits how many of these sweaters can be imported each year. This limit raises the cost of each sweater by about US\$ 12, increasing the wholesale price by 38 percent. For cheaper products made of fabrics such as cotton, the effects of quotas are even more severe.

TABLE 2: HOW THE U.S. QUOTA INCREASES THE WHOLESALE COST OF LADIES' SWEATERS FROM CHINA

Quota: US\$ 12.00	
Tariff: US\$ 5.95	
Production cost: US\$ 25.90	

Source: Tanzer, A., 2000. "The Great Quota Hustle," *Forbes*, March 6, p. 20.

Eliminating the quotas would result in significant savings of about US\$1,000 for a family of four, which typically spends approximately 5 percent of its disposable income on textile and apparel products (Bureau of Labor Statistics, 1998-2001). Moreover, not only US consumers will be bereaved of the benefits of cheap Chinese textile products, those companies that manufacture goods in China will have to pay hundreds of millions of Dollars to foreign governments for quotas. US companies that have invested significant amounts of money in China in the anticipation of a more liberal trade environment after the phase-out of quota may be hit most severely. If the European Union and Japan were to follow the US strategy, this would of course aggravate the existing market distortion.

Third, the global economy would be also affected by the possible US safeguards actions against China, as the value chain for China's export production is spread across the globe. For example, the supply chain from an industrial park in Suzhou to a supermarket in New York, is full of different participants from all over the world. A Singaporean company may own the real estate. A Hong Kong company may own and manage the factories. A German company may supply the equipment. A US brand owner may design, brand, and import the products from China. A Korean Shipping company may take the goods to the US. A US chain store may arrange the logistics and retail the product to consumers in New York. This makes the products

made in China fundamentally different from, say, those made in Japan. While Japan's *Keiretsu* system tends to keep the value chain for export production among Japanese businesses, the value chain for China's export production is international. The biggest part of the value added in the China trade actually goes to Americans, Europeans and other countries' citizens. Therefore, if the trade between the US and China were seriously disrupted, many more stakeholders in the value chain could also suffer significant damage.

Last but not least, China's commitment to further open up its markets as a WTO member would be undermined. As stated by Sun Huaibin, Director of the Research Center of China Textile Economy affiliated with the China National Textile Industry Council, China has honored its WTO commitments on textile products, including reducing import tariffs, and the country's market for textile products has opened wider than that of the US. A statistic released by China's General Administration of Customs indicates that China imported US\$ 447 million worth of textiles and apparel from the US in 2002, up 23 per cent year-on-year. In the first quarter of 2003, China already imported US\$ 200 million worth of such goods, up 190 percent year-on-year. Meanwhile, China imported 110,000 tons of cotton from the US, 170 times more than in 2002 (*Business Weekly*, June 11, 2003). If the safeguards are invoked, China is very likely to take retaliatory actions at one point. Consequently, US textile producers would also become the losers due to this protectionist campaign in which China as a potential net textile importer would close its market in return.

In sum, there would be considerable knock-on effects if the safeguards measures are invoked. They might not only hurt both nations' economic and trade benefit, but also hinder the liberalization process of the international textile and clothing regime. The value chain of international trade has now evolved to a state in which distortions and shocks cannot be solved by bilateral agreements alone, all parties involved should treasure the importance of multilateral trade regimes such as the WTO, which should not be distorted by short-term political considerations.

6. Concluding Remarks

This paper has reviewed the historical evolution of protectionism in international textile and apparel trade and examined the recent case of US safeguard measures against China from four different perspectives. The analysis indicates that there seem to be still a long way to go for both developed and developing countries to sufficiently liberalize their trade as suggested by the basic WTO principles.

On the one hand, China's real gain based on its competitive advantage in textile and apparel manufacturing might not be so significant as popularly expected in the existing literature assessing the impact of China's WTO entry, because China-specific transitional safeguard and special textile safeguard provisions in China's WTO accession protocol make it pretty easy for Western countries to impose new restrictions. Chinese policy makers and enterprises should take account of this possibility and start planning early on how to deal with the emergence of this problem.

On the other hand, the US authorities should consider the overall impact when considering invoking its safeguard measures. In addition to the prices paid by US consumers and companies in the upstream and down stream of the value chain, the invoking of the safeguards measures would slow down the liberalization pace of

the international textile and clothing regime and delay the reallocation of resources locked into unproductive industries in the US. It also needs to be taken into consideration that if China decided to retaliate against US safeguards, trade relationships between both countries could deteriorate.

In this concluding section, we highlight several policy warnings and suggestions to policy makers in the US, China, and other countries with a similar concern. First, the "WTO-plus" provisions as represented by the transitional product-specific safeguard and the special textile safeguard that were tailored for China, are discriminatory and inconsistent with the principle of normal WTO practice. Any country should only invoke this restriction under the most extreme conditions. Unless it can be sure that the increased imports are the real source of serious damage to domestic markets, any other arguments should be perceived as a quick fix in response to short-term economic pressure or as politically motivated. Sustained restrictions would most certainly undermine China's further reform attempts and demoralize China's commitment to the implementation of its domestic market opening measures in accordance with WTO membership obligations. It could even undercut the confidence of other developing countries into the fairness of the WTO system and "reduce the prospects for the timely and successful conclusion of the new round of multilateral trade negotiations" (Lardy, 2002).

Second, restrictions on imports from China are not a real solution to the US trade deficit. As Lardy (2002) and others continuously point out, the increasing US trade deficit is the consequence of an extraordinary low rate of domestic savings in the US. According to a recent Morgan Stanley equity research report, America's net national saving rate, the portion of national saving that is available to fund the actual expansion of productive capacity, fell to 0.7 percent of GNP in the first half of 2003 (*Global Economic Forum*, July 7, 2003). Given the macroeconomic identity that saving must equal to investment, the US, lacking domestically generated saving, has to rely on borrowing from abroad. Only the countries, which have trade surpluses with the US can lend money to US. If the US were not be trading with China, it would be forced to run trade deficits with other nations. Therefore, unless US savings rates rise or the rate of investments fall, limiting the import is not an effective way to reduce the US trade deficit. It is also worth noting that the growing US trade deficit with China is partly a result of the reallocation of alternative supply sources of labor-intensive products from other Asian country like Hong Kong, Taiwan and Korea, to China. It is a completely different story in comparison with the Japanese case. Japan mainly produces capital-intensive goods and these productions do not displace productions in developing countries but primarily in the US.

Third, a policy based on trade protection is typically a short-term solution for maintaining the output, employment, and income in a given industry. In the long run, resources must be pushed into best uses, where the country has the highest competitive advantage, otherwise the overall costs of safeguards measures will continue to rise year after year, in the forms of higher consumer prices and misallocated resources. Looking back in history, most of the resources now employed in the textile and clothing industries in developed countries did not even exist in the early 1960s. If there were no protection of the textile and clothing industry in place, these scarce resources together with the locked-in human capital would have been much better used in other directions.

Finally, thanks to the globalization process, the value chain of production and trade has become spread around the globe. As a result, the global trade flows

can no longer be governed bilaterally, but only by multilateral regimes such as the WTO. Therefore all governments should make efforts to avoid playing the WTO rules for the advantage of certain domestic interest group and to prevent the recurrence of the classical tragedy that opportunistic politics leads to bad economics and social welfare.

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