Chapter IV

CHINA’S TEXTILES SECTOR: PERFORMANCE AND CHALLENGES

I Introduction

Textiles sector occupies a special significance in China’s economy. Considered as a pillar industry, its contribution to the economy in terms of foreign exchange earnings and employment is noteworthy. Currently more than 20 million people are employed in the sector, representing 22 percent of total employment in the manufacturing industry. Besides, another 80 million are estimated to be indirectly dependent on this sector. With its abundant supply of low-cost and skilled labour, China has become a large producer and exporter of textiles and apparel.

This chapter aims to examine the overall performance of the sector in the context of China’s integration with the world economy. The chapter is divided into four sections. Section II analyzes the positioning of China’s textiles sector in the pre-WTO phase, focusing on policy changes introduced by the Government and the role FDI played in the sector. Section III deals with how the textiles and clothing (T&C) sector is placed in a global perspective and how it has performed in relation to exports after joining the WTO. Section IV analyses the challenges and future prospects for the textiles sector. Section V provides the summary.

II Textiles Sector in Pre-Entry Stage

Economic reforms and open door policy initiated in the late seventies gave a new direction to China’s economy. The leadership began to realize that China with its gradual and pragmatic economic policies could improve its industrial performance at domestic and international levels. It chose the T&C industry as one of its domestic industries for promotion. There were two reasons for this choice. First, China had basic infrastructure and experience in this industry. Second, this industry (mostly

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16 Textiles sector analyzed in the chapter includes textiles and clothing (T&C).
17 Such huge employment figures are because of the displacement taking place in the agricultural sector as part of growing imports available at http://eu2.mofcom.gov.cn/aarticle/chinanews/200509/20050900352110.html
textiles) is a labour-intensive one and it did not require very advanced technologies. It could exploit comparative advantage since the country had a large population and abundant labour force. This advantage encouraged the Government to embark on a reform programme in 1979, aiming at a strategic integration with the world economy by following a ‘dual track’ policy. This policy focused on liberalizing FDI and sourcing imported inputs for select industries like textiles to become matured enough so that it could take on the global competition.

Since the early eighties, China’s industrial drive has adopted a three-pronged strategy. First, the government aimed at developing endogenous productive capacity through SOEs or government support by paying attention to science and technology policy, and then linking the SOEs with the private sector or research institutes. Secondly, domestic T&C industry with the government support remained alert to integrate itself with the world economy. The industry has gradually and strategically integrated into the world market in order to have access to technology, capital, skills, raw material, and world market. Thirdly, the government followed a gradualist approach to adjust to the market economy. In the eyes of the policy makers market and government policies were to supplement each other and as the economy progresses gravity of each would change. Deng Xiaoping had referred to this strategy as “crossing the river by feeling each stone” (Deng Xiaoping Selected Works vol.3: 51).

As a part of this strategy, China launched a policy called “Six Priorities” to promote the T&C industry. Under this policy, the industry enjoyed favourable treatment in six areas: supply of raw materials; fuel and power; innovation and its transformation and infrastructure construction; bank loans; foreign exchange, imported foreign advanced technology; and transportation. As a result, the industry’s output rose rapidly. From 1979 to 1982, the average annual growth rate of the total value of T&C output was 13.2 percent. China could attain such growth because of continuous economic reforms, improving living standards, foreign trade expansion, and continuous increase in demand both in domestic and foreign markets. The Chinese products began to impact significantly during the early 1980s in international markets, as a result manufacturing industry; especially the T&C sector drew more attention from the Government.
Around 1980 China had moved away from the traditional stereotype model of a developing country dependent syndrome where dependence on exports of primary commodities was strong (Todaro 1994: 229). During early 1980s, manufacturing exports started soaring up and reaching almost 50 percent of China's entire exports as against 24 percent from resource-based products, and 26 percent from agriculture. This share of manufacture further rose to secure 62 percent of China's exports in 1995 and continued to experience high growth consistently at that level in 2001 and 2002 (Martin and Manole 2008: 207-208). The textiles sector had figured prominently as a potential manufacturing sector having vast opportunity for its expansion (Zhu 2009: Personal Interview). It had huge demand for domestic consumption as well as for exports. The government had subsequently laid emphasis by creating industrial clusters in this sector to expand domestically as well as to push its export demand.

Subsequent adoption of establishing industrial clusters in textiles popularly known as Special Economic Zones (SEZs) to boost the sector was given state preference. These T&C clusters are located in the Eastern coastal region, the most industrialized area of China, covering the Pearl River Delta (PRD) and Yangtze River Delta (YRD). These areas contribute significantly to the growth of national GDP as well as cater to the growing demand of exports. Zhejiang, Guangdong, Jiangsu, and Shandong provinces and Shanghai municipality are the five top exporters of China's textiles, representing 80 percent of total textiles output.

Opening up to the outside world had accelerated the opportunities for exports. Gradually T&C clusters in China focused their orientation towards exports. Raw materials and processed apparel products are often cheaper in China and their quality is increasingly confirming to the global standards. This led the Government to realize that the T&C has immense potential in the world market and supportive policies must be formulated to give the sector a boost. Textiles exports in China had earlier greatly benefited from the rural reforms that took place in the late 1970s. Sharp rises in the cotton production in the 1980s provided abundant supply of raw materials for textiles production. The fact that the Chinese economy was fairly closed during the early 1980s, value-added domestic inputs became quite vital for domestic production, to help exports match the international standards.
Between 1979 and 1984 cotton production nearly tripled with the input of technology coming from abroad through foreign direct investment (FDI) thereby increasing the volume from 2.2 million tonnes to 6.3 million tonnes (State Statistical Bureau, 1985). By 1988, China’s market share had peaked accounting for more than 22 percent of total textile exports originating in developing countries, or 7 percent of the world’s textile exports. As for clothing exports, China’s market share has continued to increase. By 1994 it accounted for 26 percent of clothing exports originating in developing countries, or 16 percent of world clothing exports. In 1994, China overtook Asia’s newly industrializing economies (NIEs)—Hong Kong, South Korea, and Taiwan—as the world’s largest clothing exporter.

Around the mid-1990s China emerged as a significant player in world textiles. It registered the highest exports of T&C in the world in 1995 and also in 2002 soon after its accession to the WTO. Its world market share rose from 22.5 to 30 percent over this period in the clothing sector and from 16 to 22 percent in the textiles sector. By the late 1990s China had become one of the world’s largest textiles producers and exporters. The production and exportation of textiles became vital both for its economic development and foreign exchange balance. It also helped to create a balanced supply and demand, and sound trade patterns for textiles in the world market (Yongding, Bingwen and Hongren, 2000: 437).

The T&C industry in pre-WTO era looked quite promising. China consistently figured among the top 20 exporters in the world from the mid-1990s. In 1995, it exported textiles worth US $ 3.8 billion to the world taking into account products-textiles fibres, yarn, fabrics and clothing classified under Standard International Trade Classification (SITC)\(^\text{18}\) Nos. 26, 65, and 84. During 1996–2001 it experienced certain fluctuations in its exports to the world. Towards the last quarter of 2001 at the time of its entry its total exports of T&C registered US $ 5.4 billion showing an annual average growth rate of 6.3 percent over 1995 (UNCTAD Statistical Hand Book 2007).

From the mid-1990s onwards, China’s major export destinations have been countries like the US, Japan, Germany, Hong Kong, Singapore, Italy, etc. Since 1995 its exports

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\(^{18}\) Standard International Trade Classification (SITC) is a classification of goods used to classify the exports and imports of a country to enable comparing different countries and years. The classification system is maintained by the United Nations.
to the US had witnessed a progressive rise. In 1995, it exported US $ 3.1 billion to the US and reached US $ 4.53 billion in 2000. Between 2001 and 2002, the jump in exports is significant which suggests that opening up and joining the WTO has helped to integrate better with the world economy in the T&C sector. Similarly, the Chinese exports to Japan have been steadily rising from US $ 8.7 billion in 1995 to US $ 13.5 billion in 1998. But in 1999 and 2000 the growth in exports has come down bordering about US$ 11 billion. China's exports to Germany between 1995 and 2001 have seen several ups and downs. In 1995, it exported US $ 956 million worth of products to Germany, but in 1996 it registered a decline by bringing it down to US $ 845 million. Similarly in 2000, US $ 1.09 billion worth textile products were exported whereas in 2001 it amounted to 961mn. Singapore, a neighbour and an active partner in ASEAN imported substantially worth US $ 749 million in 2000 and US $ 718 million in 2001 from China. Hong Kong, another important trading partner of China and a major commercial hub in East Asia also saw some fluctuation in its import growth from China on T&C, registering 12.9 billion in 2000 and 10.2 billion in 2001 (World Trade Atlas Online Database 2009).

Similarly, it can also be observed that few countries have consistently performed better in terms of percentage share of world exports of T&C. China, Turkey, Mexico, and India are some of the countries whose shares have steadily risen in the global market. China has been a frontrunner in the percentage share of exports. From 1995 it has shown a steady rise, registering 11.04 percent to 12.12 in 1997 to 11.77 in 1998. Its share in 2000 was 13.86 and in 2001 it went up to 14.58 (UNCTAD Statistical Hand Book 2007:17) which means China's T&C sector remained globally competitive throughout. China's exports in pre-entry period are also analyzed from another trade database (WITS COMTRADE Database). In this analysis, performance of the EU as an important trading bloc having 25 member states has been explained.

The analysis found that the EU's imports from China on T&C (Articles 61, 62 & 63 of HS code\textsuperscript{19}) noticed a rising trend. In 2000, it amounted to US $ 3.31 billion and went up to US $ 3.39 billion in 2001. Similarly, under categories 62 and 63, the EU's imports from China went up from US $ 4.41 billion to US $ 4.79 billion and US $ 0.83 billion to US $ 0.87

\textsuperscript{19} The Harmonized Commodity Description and Coding System, generally referred to as Harmonized System or simply HS, is a multipurpose international product nomenclature developed by the World Customs Organization (WCO).
billion. Imports of USA on same products from China witnessed a rising trend. Under HS code 61 imports registered US $ 2.38 billion in 2001 from US $ 2.14 billion in 2000. Likewise, under HS code 63 it went up marginally from US $ 1.18 billion in 2000 to US $ 1.29 billion in 2001 (WITS COMTRADE Database). By 2001 China had begun to dominate the world scene by registering US $ 48 billion, leaving behind most of the competitors in the T&C sector (World Trade Atlas Online Database 2008). In terms of employment, this sector continues to hold promise for its people. The T&C sector in China exuded confidence and growth. China’s T&C industry has matured from early phase of its industrialization till date and continues to contribute significantly to the world trade. It had the largest share of world trade in textiles and clothing. It captured US$ 16.14 billion (10.2%) and US$ 30.07 billion (18.1%) in world exports of T&C respectively in 2001 (Statistical Year Book of China, 2001). The overall steady growth in T&C before joining the WTO had necessitated urgency in the government’s functioning to plan out strategy to join the WTO. Its preparation to join the WTO had called for several measures to be taken up in China. Key actors like the Central Government; trade & industry, have played a prominent role. Institutional and structural changes were brought about in various sectors keeping in view the requirements of the WTO. Policy changes were made at different stages. Such important changes are explained below.

II.1 Structural Changes in the Policy-Making Bodies

One important change has been the abolition of the Ministry of Textile Industry which has been in charge of planning, production as well as policy-making for the national textile industry. The Government is mainly responsible for setting guidelines for the industry development, exercising macro control and making adjustments. Presently, the State Development and Reform Commission (SDRC) is responsible for monitoring and controlling the economic operations of the industry as well as establishing plans for the industrial development. The Ministry of Commerce (MOFCOM) is in charge of areas for textile trade policy, and the State-owned Assets Supervision and Administration Commission (SASAC) is managing and supervising the state-owned assets in the textile industry, particularly the restructuring and rationalization of state-owned enterprises. The China National Textile Industrial Council (CNTIC) was separated from former Ministry of Textiles and made into a non-governmental intermediate organization, mainly responsible for guiding the
industry in improving its performance and providing consultancy services for the industry.

Another significant development in the textiles sector has been the establishment of the China Textile Academy (CTA) which remained originally affiliated to the Ministry of Textile Industry. This was opened under the initiative of the Central Government and was founded in 1956 to develop skills for large scale domestic production. It was only around the mid eighties that this academy significantly contributed to the skills development and provided coordination and planning to the domestic textiles enterprises to expand growth of textiles in the country. The success of CTA generated interest in the Central Government to widen its role in the economy. In 1999, the CTA was transformed into a large-scale high-tech enterprise directly under the Central Government and developed into the biggest and comprehensive Research and Development (R&D) institution and high-tech enterprises group in China's textile industry. It is equipped with advanced and professional instruments, facilities, and production workshops for trial.

II.2 Government Policy towards State-Owned Mills in the Textile Industry

By the end of 2001 and the early part of 2002, state-owned economic component had a diminished role in China's textile industry. State-owned enterprises in the whole textile industry were 2,723 in total, accounting for 11.5 percent, whereas non-state-owned enterprises are numbered at 20,877, occupying 88.5 percent. The non-state-owned enterprises tend to perform better than state-owned enterprises. During 1986–1999 non-state enterprises like the Town and Village Enterprises (TVEs) contributed much more significantly to the total output accounting for 61 percent of total textile output and 98 per-cent of clothing output (Yang 1999: 7). The performance of textile enterprises varied geographically and across sub-sectors. Profits earned in western and central China were much lower than those earned in the eastern China. The government was aware of the textile industry's problems and yet had withdrawn subsidies for the loss-making state-owned enterprises such as preferential tariff and value-added tax treatments. In the wake of competition, SOEs were unable to deliver.
Huge staff concentration and non-performance led to the closure of many SOEs in this sector. Protests against incidents of such lay-off were wide spread.20

The Central Government’s full intention of joining the WTO, however, propelled the industry to undergo certain restructuring. The overall principles of industry restructuring were as follows. Inefficient and unprofitable state-owned enterprises in all sectors of the textile industry were phased out. Big and medium sized state-owned enterprises were restructured into joint stock enterprises by listing on the stock market, joint venturing with foreign investment as well as developing mutual share holding. Medium and small sized enterprises having high debt ratio, but with advanced equipment, better management and market for the products were encouraged by the government to revitalize them through assets restructuring for reducing the debt ratio. The government also encouraged other medium and small enterprises that were financially in an advantageous position and were regarded crucial to the growth of the textiles sector. These small enterprises were given favourable treatment over large because they were still found competitive in spite of high debt ratio. It helped them through schemes like resorting to foreign trade development fund as well as discounted interest rates for technological upgradation.

II.3 Chinese Government's Policy on Domestic Wool Usage

Wool has been a major input for China’s success in garment industry in the world. Realizing this, the Government had taken certain major steps to promote its production. Although China itself has the world’s largest sheep population (143 million), it is strongly dependent (70 percent) on imported wool for its wool textile industry. Though it produces a variety of coarse and semi-fine wool types that are generally of a low quality; hence used mainly in carpet manufacturing. It is said that the Ministry of Agriculture wishes to see more domestic wool to be used by state-owned wool textile mills but this seems to be difficult given that 95 percent of wool textile mills are non-state-owned. So there are no specific favourable policies in place for domestic wool usage. Production of wool has been stepped up in 2005 as the world witnesses more trade in this sector. Production in wool industry has increased

20 Many demonstrations were made by textile workers at Nanchong, Sichuan province, Shanxi, and Hefei despite tight restrictions on such activities. In January 1999, hundreds of workers from the Chngde textile plant in Hunan province protested against lay off of 30 percent of mill workers (China News Digest, No. 408, 22 January 1999).
year on year with accumulated production of wool yarn increasing moderately by 3.5 percent and wool fabric growing by 17.7 percent respectively.

Performance of wool industry was rising steadily in the same period. Sales revenue of 1233 above-scale wool spinning and weaving mills and 1523 above-scale wool knitting mills have strongly lifted by 32.3 percent, 32.1 percent year on year; total value of export shipments has increased by 25.0 percent, 27.3 percent and 10.8 percent respectively; accumulated production/sales ratio reached to 95.94 percent, 98.52 percent; profit gains sharply increased by 40.4 percent and 40.7 percent as well. This is a strong indication of the industry moving in the right direction. Domestic sales being the key driver for industrial development, the industry's growth rate of sales revenue has exceeded that of export value indicating a stronger domestic market for the industrial sectors. Exports also gradually experienced high growth. In contrast, exports of wool yarn and wool knitwear have slowed down with traditional destinations of Hong Kong and Japan taking lower volumes. Overall, in the field of T&C, a rising market share for China was noticed around the time it completed its accession to the WTO. During the 1990s it increased its market share in the EU (WITS Database), Canada, and the US, but the surge that most of the people had expected didn’t take place. This is evident because higher tariffs as well as quota were still restraining China’s trade with them. Beginning 1 January 2002, China felt the pressure of reducing the tariffs imposed by developed countries.

II.4 FDI in Strengthening the Sector

One of the key elements of China’s economic reform process has been the encouragement of FDI. In the textiles, the FIEs are not as important but still account for about 20 percent of the industry’s total number of firms in output and in value-added services (Fung et al, 2002, pp 14-15). It was predicted that the FIE’s contribution in this sector will see an upward trend (Zhu 2009: Personal Interview).

China has also been a major recipient of FDI from the Japan. In fact, the Japanese firms started investing in China as early as 1981. Textile sector is the third largest in terms of cumulated FDI. It received 200.4 billion yen direct investment from Japan from 1989 to 2001 (Xing 2004: 6). Investment came heavily into this segment because garment industry is labour-intensive and China enjoys comparative advantage.
in the international division of labour. Both could reap huge benefits by producing textile products in China due to its rich labour endowment. These direct investments from Japan have been export-oriented and they helped immensely in promoting China’s manufacturing exports. Most of “Made-in China” products available in the Japanese domestic market carry Japanese brands, and many products under Japanese MNEs’ brands in global market are made in China. For example, the Japan Wool Textile Company Ltd. produced garments in a plant located in China for exports. Japanese investment in textiles industry was fairly strong during late 1980s and early part of the 1990s. This reflects a clear strategy behind the Japanese investment in China, making it as a cheaper production base essentially to cater to its domestic market and for world exports.

Another significant characteristic of the Japanese direct investment in China is that these investments are actively engaged with reverse imports, which refer to the products made at overseas Japanese plants and exported to the Japanese market. Rising yen and shrinking domestic demand have compelled many Japanese firms to relocate their domestic production to China, and in some cases simply outsource their production to the Chinese firms. The Fast Retailing Co., which designs, distributes, and markets UNIQLO brand products in Japan, produces the products in its China’s affiliates, or subcontracts to China’s domestic firms. Thus China has emerged as the most popular destination for the Japanese direct investment since the middle of 1990s. According to the survey of JETRO (2001), among the Japanese firms with overseas production facilities, 54.4 percent of them have production facilities in China, the highest among all foreign countries. Around this period, China was emerging as an ideal location for regional investment.

China sourced more than 80 percent of its textiles raw material imports from Japan, Hong Kong, Chinese Taipei, and the South Korea. In addition, China also sourced most of its inputs like technology and skills for its domestic clothing industry from these countries.

In 2005–06 China received FDI to the tune of US $ 60 billion, out of which the textiles sector received about 10 percent. The FDI in T&C continues to increase in China. Most of the investments came from Hong Kong and other South East Asian countries, and not so much from the US and EU. In 2007 China received FDI worth
US $ 1.8 billion in the T&C sector, which is about 2.5 percent of total FDI it received from the world (Guoxing 2009: Personal Interview). According to many trade experts in China, FDI has played an active role in promotion of China's T&C sector. "It has brought in technology, skills and capital to upgrade and revitalize the sector to take full advantage of industry's integration with the global industry," according to Prof. Wang Guoxing (Guoxing 2009: Personal Interview).

III Textiles Sector after its Entry into the WTO

Accession to the WTO in 2001 opened up a plethora of opportunities for China's exporters of T&C products in the global market. Having obtained the WTO membership it became a beneficiary of the global trading in apparels, more particularly the Agreement on Textiles and Clothing (ATC). China could now position herself to take advantage of the phase-out of the quota under the third phase of the ATC (which was put into force on January 01, 2002) and could look forward to the benefits accruing from the final quota phase-out (which was implemented on January 01, 2005). Many observers (Tatsufumi 2007: 7, Knappe 2003: 18, ILO 2005: 30) believe, China is well poised to take full advantage of the opportunities of the global market once the quota-free regime was in full effect.

China's potentiality in T&C was known to the world. By becoming a member in the first year of joining it had improved its global share from 13.86 to 14.58²¹ and had increased its volume of exports from US $ 48 billion in 2000 to US $ 49 billion in 2001.²² Its global competitiveness came to be well recognized by other competitors. The reasons for this success were due to a number of factors. Besides exchange rate manipulation, there was a host of other explicit and hidden policies, which according to the ILO report, gave China a competitive edge vis-à-vis other countries. China's 13 percent tax rebate on T&C products, government subsidies given to the state-owned textile and apparel enterprises (which, interestingly, comprises 52 percent of the textile sector and 25 percent of the apparel manufacturing sector in 2003 and 2004), and availability of "free credit" for both the public and private enterprises provided, China significant opportunities to undercut other competitors. The T&C trade invites particular attention in China because it is one of the largest sectors and its contribution

²¹ Calculated from UNCTAD Statistical Handbook 2007 based on (SITC 26+65+84)  
²² World Trade Online Database, 2008 based on (HS codes 61+62+63)
in terms of export and employment is significant. The peculiar structure of earlier
global textile architecture before 2005 was so restrictive in nature, that many
developing countries whose potential to perform better could not get reflected in their
economies. China is one such country.

As is well known, T&C exports from developing countries to the industrial countries
are subject to high tariffs, hovering around 8.9 percent for the US and 12.4 percent for
Canada (WTO 2001: 11), and are also subject to a system of bilateral quotas that were
developed under the MFA. Though agreement was reached in the Uruguay Round
(1985–94) to phase out quotas against developing countries’ exports of T&C, yet it
did not help China to enjoy those advantages because by then China had not acceded
to the WTO. The major turning point came on 1 January 2005 when the abolition of
quotas was implemented. During this course of development some other WTO
members like the EU, Canada, etc., retained the option of trying to restrict China’s
exports using a range of provisions under China’s WTO Agreement (Bhattasali et al.,
2004, p: 28) including the product specific safeguard in China’s WTO Accession
Agreement. In addition, developed countries had the provision of targeting and
obstructing China’s exports under anti-dumping actions to which it is vulnerable
because of the non-market economy provisions (Messerlin 2004: 108). China
remained under pressure even after it had acceded to the WTO.

It started bearing the liabilities of cutting tariffs further after joining the WTO.
According to the commitment, the average duty of T&C was gradually reduced from
17.8 percent in 2002 to 11.4 percent in 2005. In 2002, the average reduction was 2.45
percent. The average duty level in 2005 was reduced by 6.4 percent compared to that
of 2002, with a reduction range of 36 percent. By 2005, all duties had reached the
binding level except for one duty number. After the duty reduction, the "ladder" duty
pattern (from low to high) was created for products from raw materials, medium
products, and manufactured products. Upon joining the WTO, China had also
abolished the import quota and licenses for products under 42 duty numbers, i.e.,
wool, acrylic, terylene, etc. From 2002, all import quotas and licenses for textiles, raw
materials, textile garments, and textile machinery were abolished. Apart from tariffs,
China cannot re-adopt or implement any other non-tariff measures after entering the
WTO, unless a large volume of foreign products are dumped or the domestic industry
suffers serious damages. Thus, pressure on China continued. Based on the agreement of the WTO, animal and plant products underwent a quarantine inspection. In 2002, the tariff quota for wool was 264,500 tons and for wool yarn, 72,500 tons. These figures jumped to 287,000 tons and 80,000 tons respectively in 2004. From 2002, the number of companies appointed to trade in wool, wool yarn, and acrylic also rose gradually. By 2005, trading rights were relaxed. While cotton imports continued to be traded by state-owned enterprises, non-state-owned enterprises continued to have the cotton import rights. The Government slowly abolished the State-owned trading rights system of silk by increasing and expanding trading rights to non-state sector. By 1 January 2005, the Government completely abolished all active restrictions on silk exports, including all procedural fees. After the WTO accession, the state-owned trading system of the "two yarns and two fabrics" and silk, and raw silk were amended, and trading rights were opened to all enterprises. Exports of raw cotton fabrics to Japan and South Korea were exported under a quota, and export licenses were applied according to relative regulations. Such pressures propelled China to augment its technical skills, financial resources and infrastructural development to sustain its export growth and explore new opportunities in world market.

III.1 China's Export Scenario in Post-Entry Period

The changes that have been introduced from 1995 to 2001 have had a tremendous impact on China's performance in the major importing markets. For example, US T&C imports from China increased by 125 percent in 2002, a trend that continued in the first three months of 2003. In the same period, apparel exports increased by 60 percent. The Chinese exporters reduced their prices in order to gain a greater share in the market. They were able to do so, among other reasons, because quota rents were reduced and the Chinese enterprises increased their productivity by investing heavily in new machinery and technology (Knappe 2003: 20). China had soon become a dominant player in the T&C markets. By becoming a member of the WTO, it could promote its trade within a short span. China exported 19.3 and 5.9 percent of textiles to Australia and South Africa respectively in 1995. The corresponding market shares had expanded to 35.2

24 Profits made by companies that are allocated the rights to import goods, that are subject to quotas and are therefore artificially scarce.
and 18.5 percent in 2002. It also became a dominant trading nation in the clothing sector with a respective market share of 54.3 percent in Australia and 29 percent South Africa in 1995. By 2002 it could register as much as 70.4 and 56.3 percent in these markets (Nordas 2004: 16–17).

**Figure 1: Major Exporters of T&C in Post-Entry Phase (US $ Million)**

Source: UN COMTRADE Database 2010, WITS, Accessed on 15 July 2010, URL: http://comtrade.un.org (basic data of all the graphs are in Appendix II)

Note- Based on HS Codes 61, 62 and 63

China’s T&C sector in the post-entry phase looked promising. From Figure 1 it is understood that in 2001, the year it joined the WTO, its exports to the world reached US $ 36.1 billion (products based on HS codes 61, 62 & 63). It continued to witness significantly high growth touching US $ 62.5 billion in 2004 and thereafter registering US $ 130.1 billion in 2008, thus signifying global dominance in the world market. From the Figure 1 it can be noticed that Hong Kong was the nearest rival touching US $ 26.8 billion in 2008 and the major industrialized country, the US had recorded a
meager US $ 5.2 billion. Whereas, world exports in T&C had touched US $ 385.2 billion in 2008. The study has also analyzed China’s position in T&C in the world market from another source, i.e. UNCTAD Statistical Hand Book 2007. According to this source (products based on SITC 26+65+84), China maintained a steady rise in its exports to the world by reaching US $ 54.2 billion in 2001 to touch US $ 145.5 billion in 2006. This source further explained that in the post-entry scenario China’s exports to the world on T&C has experienced steady growth (Appendix III).

**Figure 2: China’s Annual Export Growth Rates in T&C in its Major Markets and the World in Post-Entry Phase**

![Graph showing China's annual export growth rates in T&C in its major markets and the world in post-entry phase.](image)


Note- Based on HS Codes 61, 62 and 63

It is observed from the Figure 2 above that China’s annual export growth rate to its major trading partner, the US had shot up from 2 percent in 2001 to register 27 percent in 2004. During 2002-2004 this growth rate has observed a substantial rise touching 18 and 35 percent in 2002 and 2003 respectively (Appendix II). Such huge growth had occurred as China had joined the WTO. More opportunities for China
were created. With this key development in global economy, faith and confidence of the US in China’s trade practices were restored. Cotton knit shirts and trousers showed the highest growth with 18 million shirts shipped from 1 million (1,332% growth) and 27 million trousers shipped from 1.9 million January 2004 (1,836% growth). Industry figures show a decline of 45 percent in prices in cotton trousers and 28 percent in cotton shirts (China Customs).

Most increases in shipments are fuelled by China’s ability to manipulate and control its pricing structure in textile and apparel products. This could affect eight product groups (China Customs) such as brassiers, cotton knit shirts, men’s wollen shirts, cotton trousers, dressing gowns, underwear, man made fibre knit shirts, and man made fibre trousers that represent the major employment and production sectors of the US yarn and fabric industry. In 2004, the Chinese exports of apparel in quota-free categories increased by 513 million square meters, or 55 percent, and brought China’s share of the US import market in these categories to a record 70 percent. Imports from the rest of the world fell by 91 million square meters in 2004 (US Department of Commerce). China’s share of 25 apparel categories increased from 10 percent in 2001 to 34 percent in 2002; 57 percent in 2003 and now to 70 percent in 2004. The study by Nordas (2004) suggested that China could capture 29 and 50 percent of the EU and US markets. In December 2005, China had a 72 percent share of the import markets of the US, Hong Kong, and Japan. From Figure 2 it is noticed that China had secured an annual export growth rate of 83 percent share of the US market.

To this development, the US government and textiles association has sharply criticized the Chinese government, by alleging that China has adopted wrong means to boost its exports. The Chinese government employs numerous illegal and unfair trade practices to ensure that the Chinese exporters can under-price their textiles and apparel. Anti-competitive actions by China’s government claimed by the US industry include currency manipulation (estimated to provide up to 40% subsidy for the Chinese exporters), illegal direct government subsidies of its money losing state-owned textile and apparel sectors; illegal export tax rebates (13%); and the deliberate extension of billions of dollars in non-performing (free money) loans by China’s central banks in order to award a competitive advantage against foreign competition (National Council of Textile Organization: 2004). Import curbs on the Chinese
textiles products are sometimes arbitrary. As China entered the WTO and continues to be a non-market economy, it was easy for developed countries to impose dumping measures whenever they see danger for their domestic industry (Guoxing 2009: Personal Interview).

As the Chinese exports had surged, exports from the US free trade and trade preference countries fell sharply, mainly from NAFTA countries. With the removal of quota control, the US imports in apparel products from Mexico fell nearly 50 percent to 40 million square meters over the last three years and Mexican market share declined from 8 per-cent to 2 percent. The Caribbean and Central American countries also saw sharp decline. The impact on the US industry has been felt most in North Carolina with 126 plants closed since 2000. States like South Carolina, Georgia, Virginia, and Alabama also experienced huge losses by closing down their 70, 34, and 30 plant operations respectively during this period. The National Council of Textile Organization (NCTO) claimed that over 200,000 jobs have been lost in 5 years. It is also argued that apart from open and implicit subsidies given by the Chinese Government to its producers, it is the artificial low rate of exchange between the Chinese currency and the dollar that had resulted in massive surge in Chinese exports to the US. China has been letting its currency fall apace with the dollar over the past few years, thus giving its exports a large cost advantage vis-à-vis exports to the US from most other countries.

Likewise, it is clear from the Figure 2 that China’s annual export growth rate to South Korea had registered 38 percent in 2001, which further came down to 9 percent in 2004, indicating South Korea’s decline in imports of the Chinese T&C products. China’s export to Germany noticed a negative growth of 3 percent but had increased to 24 percent in 2004. This explains the rise in opportunities and demand in Germany after China joined the WTO. China’s exports to Germany had seen a positive trend as China registered annual export growth rate of 17 and 47 percent and 83 percent in 2002, 2003 and 2005 respectively. (Appendix II). Similarly, Hong Kong has been a favourable destination for export of the Chinese T&C products as China registered an annual export growth rate of 22 percent in 2002, more than the US in that year. However, Hong Kong imported less compared to Germany in 2004 from China. Such volatility of Chinese T&C exports to Hong Kong had occurred because the demand
for such Chinese products was less. Hong Kong and some other Asian countries were focusing less on the low technology products like textiles which China was exporting to these markets (Lall and Albaladejo 2004: 1448). During this period Japan was also another important destination for the Chinese products. It is also noticed from Appendix III that India and Mexico experienced rise in exports. However, in another study it was found that during 2002–2006 Mexico’s annual average growth rate dramatically declined registering a negative growth of 3.3 percent. This largely happened due to China becoming a WTO member (Branstetter and Lardy 2006: 51). From Figure 2, it is seen that China’s annual export growth rate to the world had also gone up registering 1 percent in 2001 further rising to 20 percent in 2004 and 22 percent in 2005.

Figure 3: Significant Export Markets of China’s T&C in Post-Entry Phase

![Graph showing export markets of China's T&C](image)


Note- Based on HS Codes 61, 62 and 63

Figure 3 explains China’s top export markets in the world. After it has joined the WTO, its exports to Japan have risen. Touching US $12.6 billion worth of exports in 2001, it registered US $15 billion in 2004. Similarly exports to the US have gone up from US $4.0 billion in 2001 to see a continuous rise till 2004 to touch US $8.2 billion. In 2005 its exports to the US in these products experienced a huge increase as China exported US $15 billion. This rise in exports explains about the elimination of
quota regime which was in place for more than three decades and came to an end on 1 January 2005. Similarly, South Korea, a key importer of China’s T&C products, has increased its imports from China. In 2001 it received US $1.6 billion imports of textiles products and went to increase its imports worth US $2.8 billion in 2004. However, its imports came down in 2005. In 2006 and 2007 it witnessed an increase in its imports from China (Appendix II). Germany, another major importer of T&C products also witnessed an increase in its import from China from registering US $0.8 billion in 2001 to US $1.7 billion in 2004.

**Figure 4: Share of Major Exporters of T&C in the World**

![Graph showing share of major exporters of T&C in the world from 2001 to 2008.](http://comtrade.un.org)


Note: Based on HS Codes 61, 62 and 63

Figure 4 provides share of major exporting countries in the world on T&C. It is noticed that China has a share of 19 percent of world exports in 2001. It has continuously improved its world share in T&C, registering 23 percent and 34 percent in 2004 and 2008 respectively. Hong Kong has been the closest rival in this sector,
whereas the US has a small share of 4 percent in 2001 and then reduced its world share to 2 and 1 percent in 2004 and 2008.

**III.2 Post-Multi Fibre Agreement (MFA) Phase**

The MFA phase came to an end on 31 December 2004. The post-MFA phase is assumed to be the most dynamic and growth friendly period as the phase out of quota restrictions gave a level playing field to the individual countries to establish their competitiveness in the T&C sector in world market. Looking at the four Figures—1, 2, 3 and 4—given above, one gets a detailed picture about China’s position vis-à-vis individual countries and the world. The analysis suggests that China has been in a unique position since it has joined the WTO. Its performance in the sector justifies that it has exploited the global opportunities in a competitive manner. Such massive rise is largely due to phasing out of quota restrictions and the end of MFA (*China Daily* 2005: 11). MFA phase out has been a push factor in China’s exports of textiles. Exports from China jumped in the first half of the year 2005 registering almost US $16 billion (World Trade Atlas Online Database, 2010) to the US, whereas in 2004 it exported textile products worth US $10 billion. However, in 2006, one year after the total phase out of quota restriction, China’s annual export growth rate to the US which had noticed an upward trend from 2001 to early part of 2005, registered a huge decline bringing it down to 21 percent from 83 percent in 2005. Germany too witnessed such significant decline as the annual export growth rate came down from 83 percent in 2005 to 18 percent in 2006. China’s annual export growth rate to the US and Germany were higher than the world rate of 22 percent (Figure 2).

It is well known that traditionally China has been a great exporter of the knit and woven textile products to the world and especially to the US. Yet this sudden increase in high volume of exports to the US in the earlier half of 2005 had created an alarming situation for the US to re-look at its trade policy towards China. It seriously considered invoking safeguards to restrict garment exports from China. Similarly the EU countries also faced a surge in textiles imports from China. The EU too equally wanted to resort to some mechanism by which it would be able to cut drastically its textiles and garment imports from China. As a result, the EU and China reached an agreement on a three-year “transitional arrangement” on June 10 2005 which limits the annual increase in Chinese garment imports to about 10 percent until trade is
liberalized in 2008. Though the transitional arrangement of China with the EU would allow the Chinese exports to continue to grow, yet at a rate that would allow the EU producers to adjust to new levels of competition. The EU also imposed certain NTBs like SPS, as a result China’s exports to Germany had decelerated in 2006 (Figure 2). The US and China made a similar agreement in 2005, restricting nearly half of China’s garment imports into the US by the end of 2008. These transitional safeguards imposed on China forced her to scout for new markets in other parts of the world. From Figure 2 it can be analyzed that in 2006 China’s annual export growth rate to Hong Kong, South Korea, Japan, etc. experienced a significant increase. The restrictions in the US and EU market had subsequently pushed China to negotiate and divert its attention towards East and Southeast Asia as a major destination for its T&C exports.

Imposition of textiles safeguard measures by the US and the EU vis-a-vis China had again crippled the natural growth of world trade in T&C. China had felt that it was going back to the restrictive phase of MFA which remained in operation from 1974 to 1994. It was only when the WTO was established in 1995; it was assumed that the MFA system of controlled and restrictive trade regime would be phased out by 31 December 2004, as such an arrangement would be against the fundamental principle of the WTO (Gereffi and Memedovic 2003: 14). These discussions on safeguard measures had formed a part of China’s accession process at the WTO.

Safeguards can be negotiated between the countries involved or unilaterally adopted. The Textile Monitoring Body in the WTO (WTO: 2005) monitors the placing of safeguards on a global basis and must approve their use. During 2005 the trade safeguards were placed by the US and the EU in the form of quotas on many textile and apparel products imported from China. Imposition of such safeguards was earlier a part of the accession clause of China to the WTO; hence it came in handy for the developed countries to restrict China’s exports. On 23 May 2005 the US imposed restrictions on three categories of imports from China. These were cotton knit shirts and blouses (category 338/339); cotton trousers, slacks and shorts (category 347/348); and cotton and man-made fibre underwear (category 352/652). On 27 May limits were imposed on an additional four products: cotton yarn (category 301); men’s and boys’ cotton and man-made fibre shirts (non-knit) (category 340/640); man-made
fibre knit shirts; blouses (category 638/639); and man-made fibre trousers (category 647/648). The reason given for introducing quantitative limits is a sharp increase in the imports of these items. Restrictions from the US government are imposed from the date of the request for consultations with China until 31 December 2005.

Surge in imports from China has also disrupted the domestic market and has heavily resulted in the loss of jobs for America. As a result, the US and China had many times entered into a row over textiles issues. In 2005, the US administration informed that it has accepted petitions from the US textile industry to launch investigations into whether quotas should be imposed on 21 categories of clothing and textile imports from China in 2004 and 2005. It observes that such petitions are against the fundamental principles of the WTO. It suggests that an amicable settlement can be arrived at by looking at prospects of both the sides (China Daily: 2005 http://www.chinadaily.com.cn/english/doc/2005-10/06/content_482840.htm).

However, its exports to the US increased to US $18.1 billion in 2006 and US $20.9 billion in 2007 (Appendix II). China’s exports of T&C in volume terms to the world have gone up to reach US $130 billion in 2008 (Figure 1). Its exports to the major industrial markets like the US and Germany have also registered an increase amounting to US $21.0 billion in 2008 and US $22.5 billion in 2008 and 2009 respectively (Figures 2 and 3 and Appendix II).

Imposition of transitional safeguards during 2005 had played a critical role in limiting the surge of China’s textile exports to the US. First of all, the transitional special safeguard measures introduced by the Agreement on Textiles and Clothing (ATC) were binding on China until 31 December 2008. Secondly, the base for quota expansion for China is much smaller and slower than other WTO Members. For instance, the bilateral textile agreement between the US and China permits an annual average growth rate of less than 1 percent, one of the lowest among importing countries. Indeed, because of this low annual permissible growth rate and the low quota bases, some keen watchers in China have expressed the view that joining ATC

would be detrimental to the Chinese textile and apparel exports. Moreover, according to the Report of the Working Party on the Accession of China which has the same legal status as the WTO agreements, it is not very clear whether China can receive ATC benefits retroactively from January 1995 when ATC took effect or from the date of the Chinese accession to WTO, i.e., 11 December 2001. The wording of the Report is thus: “To these base levels, the increase in growth rates provided for in Articles 2.13 and 2.14 of the ATC should be applied, as appropriate, from the date of China’s accession.”26

During the past seven years of ATC’s operation, T&C products were supposed to be progressively integrated into the WTO regime and quotas for the rest of the products were to be increased gradually at specified rates. Though major importing countries have not implemented ATC at the pace indicated by the agreement, there have nevertheless been some benefits. Under the application of the ATC to China, the coverage of its products by quotas is wider and the extent of quota increase will be less than for other WTO members. Under the ATC “growth on growth” provisions, until the end of 2004, the incremental increase for existing quantitative restrictions maintained by the WTO members on the Chinese exports will be no more than 16 percent while in the same period other members will, in principle, enjoy an expansion of a further 25 percent, following the first two stages of implementation of the ATC. These conditions constitute a ceiling for the Chinese exports and will make the expansion of quotas insignificant for China in some products. In addition, the Chinese utilization of existing quotas is often 100 percent or close to 100 percent, while that of countries such as Indonesia, Thailand, and Bangladesh has been hovering around 80 percent. This too puts a check on the potential export expansion for China.

Moreover, other WTO members were able to increase their exports without restriction of quotas starting from 1 January 2005 when the ATC came to an end, and their trade in textiles and clothing were integrated into trade liberalization provision of the WTO. For China, however, a special transitional safeguard continued to restrict it from

benefiting from the post-ATC free trading regime in T&C. The special safeguards allowed importing countries to impose import restraints if market disruption is deemed to be caused by an import surge while some other countries such as Mexico, Turkey, and some Asian countries will benefit from the preferential provisions of their respective regional trade agreements (RTAs).

Up to 2013 i.e., after 12 years of the Chinese accession, countries importing the Chinese products will be able to use special safeguards to address rapid increases in imports from China that cause or threaten market disruption. Imports could be considered as undergoing rapid increase when measured by volume or value relative to the previous levels so long as evidence is produced to show “material injury, or threat of material injury to the domestic industry.” These specific mechanisms permit importing countries to apply restraints unilaterally based on criteria lower than those stipulated in the WTO Safeguards Agreements. Ordinary WTO safeguards apply when imports from all sources “cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products”27 but under the transitional product-specific safeguard mechanism, importing countries will be able to evoke safeguard measures that target imports from China. Arguably, a decision to resort to trade defence mechanism could be made much more easily when the exports of only one country are affected.

It was also found that China has increased its exports through other means, i.e. by linking itself to prominent retail chains. Walmart is operating in various provinces of China without adversely impacting country’s domestic retailers (ASSOCHAM: 2006). The global MNCs have taken the Chinese products, particularly apparels, to almost all corners that one can identify in the world. Global retailers like Walmart buy about US$ 60 billion worth of goods including textiles from China (Kanungo 2006: 30). Entry of these retailers has expanded the scope of China’s exports. They source their goods from inside. Thus, FDI is instumental in building China’s productive capacity to become the world’s largest producer and exporter of textiles.

It is further analyzed on consulting the World Integrated Trade Solution (WITS) database that China’s major global trading partners like the EU and the US

27 Article 2, Agreement on Safeguards.
experienced a rise in their imports from China in the post MFA phase in the T&C products categories defined under HS codes (61, 62 and 63). China exported more than US$ 6 billion in 2004 to reach US$ 9.4 billion and US$ 10.3 billion in 2005 and 2006 respectively. Its exports to the US in 2004 registered US$ 4.33 billion to touch US$ 6.96 billion and US$ 8.44 billion 2005 and 2006 respectively. An analysis of pre and post MFA phase provides interesting results for both China and the world. It was found that the annual growth rate of garment exports of China to USA was 56.77 percent in 2005 which was very high compared to the total garments imports of USA from rest of the world which was 5.89 percent. With the imposition of transitional safeguards by the US, China’s exports on textiles shrunk significantly in 2006. The growth rate for China was as high as 18.19 percent (US Department of Commerce, Bureau of Census by World Trade Atlas).

China’s export drive on garments to the EU countries also witnessed a significant rise in 2005. China exported US $ 13, 714 million worth of garments in 2004, while the export totalled reached US$ 20, 361 million in 2005. The growth rate for China up to the third quarter of 2005 was 54.41 percent. Its growth rate for January-October 2006 was lowered and came to be even lesser than the world average of 10.74 percent in 2006 (Yamagata and Tatsufumi 2007: 10).

Another market where China’s export penetration in textiles and garments has shown upward trend in 2006 is Japan. Japan is one such market, which has always exported garments; hence it has not imposed any quota restrictions on garments in the past (Yamagata 2007:12). China has been a major exporter to Japan in post-MFA period. Japan sourced about 83–84 percent of its garment imports from China between 2004 and 2006. In spite of the structural changes made in a significant way in other two biggest markets of the world, namely the US and EU, Japan has somewhat experienced insignificant changes even after the MFA phase-out has come into force. China’s comparative advantage in textiles is noticed from Revealed Comparative Advantage (RCA) exercise. As of 2003, based on Revealed Comparative Advantage (RCA) Index, China has a high comparative advantage in textiles and electronics, while it lags behind in automobiles and petrochemical sector. In textiles RCA of

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28 Knit and woven garments are defined as commodities with HS codes of 61, 62 and 63.
29 The Revealed Comparative Advantage is a macroeconomic concept for calculating a relative advantage or disadvantage of a certain country in a certain technological field.
China was 2.97 whereas Japan's 0.28 and Korea's 1.37 (Development Research Centre of China et al. 2004 http://www.nira.or.jp/past/newse/paper/joint4/report.html).

China's strength in T&C, however, was known to the world which is why industrialized countries had negotiated such imposition of safeguard measures on its textiles products during its accession period. As China had agreed to such accession provisions, it became easy for the developed countries to impose such measures immediately after the MFA phase-out and whenever they experienced surge of textile products from China during 2005, 2006, and 2007. China's signing of Memoranda of Understanding with the US and the EU restricted the rapid growth of Chinese textiles and clothing exports to their markets. It also became a deciding factor for China to scout for export markets in other regions of the world like Southeast Asia and Africa. During this period China increased its world exports by 21 percent, 25 percent and 18.9 percent respectively (WTO, 2008).

### III.3 Industry Scenario

Though protectionism in apparel industry had a long history in the US, the global shift towards reduction of quota and tariffs had begun more than a decade back, and the ATC being in place the change was noticed. The elimination of restriction on apparel imports was brought into effect on 1 January 2005 which created a shift in the manner sourcing decisions are made. It is suggested that by removing quotas, apparel production in China will surge by 70 percent and in other Asian countries by 26 percent [United States International Trade Commission (USITC: 2004)]. The North American production is expected to decline by 19 percent and European production by 11 percent (USITC 2004).

Apparel exports from China are expected to increase by 87 percent and 36 percent respectively after the removal of quotas (USITC 2004). This is because the Chinese textile products are cost competitive and cater well to the wide variety of global demands. Such dramatic changes signal a fundamental change in the dynamics of buying and sourcing decisions. In specific woolen segment, China's performance during post-MFA phase showed significant progress. In the first 6 months of 2005, the export volumes of scoured wool, tops, wool fabrics, cashmere sweaters, wool woven apparels maintained a high growth rate of 21 percent, 55 percent, 22 percent,
78 percent and 30 percent respectively. In contrast, exports of wool yarn and wool knitwear have slowed down with traditional destinations of Hong Kong and Japan taking lower volumes. For the same period, imports of wool totalled 123,200 tons increasing by 3.2 percent year on year. Growth of major wool exports is also an important factor for industry development. During 2006–07 China’s textiles exports looked up registering around US $ 15 billion (UNCTAD Statistical Hand Book 2007).

In 2008 preliminary import figures released by the US Department of Commerce show that the Chinese apparel exports took a record 54 percent of the US apparel import market in November and Chinese exports in key quota categories were surged by as much as 132 percent as China approached the end of quotas on January 1 2009. November 2008 was the first month in history that the Chinese share exceeded 50 percent. Cass Johnson, President of NCTO, said that while Chinese exports dipped earlier in the year, this end of year surge was not a surprise: “When the Chinese government saw textile exports under performing, they did what they have always done — they increased subsidies. China has pumped $10 billion in new export subsidies into their textile sector since July and they are having the desired effect.”30 The American textiles industry lobby has expressed its deep concern to the US Government to deal with the issue to save the US domestic industry and its workers from losing their jobs as they expected a huge surge from China during 2009 since the quota imposed in 2005 came to an end on January 1 2009. The US textile industry is worried that China would use various subsidies such as currency manipulation, land, rent, privatization, financing, energy costs, etc. to surge into the US market.

IV Challenges and Future Prospects

Multiple studies and analyses done by widely varying groups and institutions have all come to the same conclusion—that China will dominate world trade in textiles and apparel once quotas are removed. These include studies by the WTO, the World Bank (Ianchovichina and Martin 2001: 21), the US International Trade Commission,31 and the McKinsey Company32 as well as analyses of China’s past trade behaviour in non-

quota countries and in apparel categories removed from quota control. In another significant study (Nordas 2004: 34) by the WTO on the phase-out of quotas predicted that China and India would take 71 percent of the US apparel market with China (including Hong Kong) gathering 56 percent and India taking the rest. The study's econometric model shows sharp declines for all major suppliers with Mexico and the Caribbean Basin countries taking an especially hard hit.

IV.1 Challenges

The T&C has a long tradition in China and its development has been central to China's industrialization process. In China's move to a market economy and its integration into the international trading system, the T&C industry has gone through a difficult structural adjustment process in which 1.4 million textile workers (the majority of whom were middle-aged women) lost their jobs during the period from 1995 to 2005 (ILO 2005: 22). In the pre-entry period lack of market competition secured the existence of small and medium enterprises to continue, as a result employment in the sector did not come down dramatically. In the post entry phase competition was set in and non-competitive firms had to wind up their business activity. This led to massive decline in employment opportunities. Through this measure of integration and competition China may have improved its position in international trade; yet the challenge of providing employment opportunities and maintaining social harmony occupies priority.

The opening of China's market entailed by its accession to the WTO led to a shift in resources in response to the forces of comparative advantage. With population increase every year, China has to provide employment for its huge labour force including the millions of migrants from rural areas who have been displaced by increased agricultural imports. Work opportunities had to be found in sectors where China possessed international comparative advantages, and the T&C industry is a key sector in that respect. Today, the T&C industry provides employment for 19 million workers (22 percent of total employment in manufacturing industry), and another significant proportion of population is estimated to be indirectly dependent on the T&C industry. Most of the human resources in China can find employment in labour intensive industries as rural mass is not equipped to handle technology-dominated
industries. Clothing being a key labour-intensive sector, the pressure on the Government will remain high to absorb people in this sector.

Private capital including foreign capital has played a leading role in the modernization of the T&C sector where adjustment has resulted in a fundamental change in the ownership structure. Currently, only 13 percent of the industry is held by state-owned capital whereas private ownership accounts for 87 percent (15 percent is foreign owned, another 15 percent is owned by companies from Hong Kong and Macau Special Administrative Regions and Taiwan, China). Such foreign capital is always necessary to upgrade modernization of the industry. Maintaining a regular receipt of large-scale of foreign capital is a big challenge for the government.

The domestic textiles industry has not progressed much in China. It is the FIEs operating in China whose contribution has been quite significant. Rules of the game in this sector have been unfavourable for China for all these years. Restrictive regime in T&C industry combined with imposition of safeguard measures in 2005 had curtailed the growth of textiles sector in the global market. The need of the hour is to develop and promote its own brands and market them internationally. This is a major challenge for the Chinese textiles industry. China is going to face wide ranging demands coming from consumers in its domestic market because the Chinese industry needs to expand (Hong 2009: Personal Interview).

Access to the most competitive inputs is an important factor in the competitiveness of the Chinese clothing industry. China’s garment exports depend greatly on the import of fabrics, raw materials and textile machinery from other countries. It is estimated that about 50 percent of exported clothing is made from imported textiles. In 2004, China’s clothing exports reached US $ 61.62 billion in value while its import of fabrics, raw materials and textile machinery from other countries reached US $ 24.02 billion. China is the world’s third largest textile importer just behind the EU and the US. The Chinese textile industry is the world’s largest importer of raw cotton. China is also among the top importers of wool in the world (220,000 tons in 2004) and the world’s largest importer of textiles machinery and parts (importing US $ 4.48 billion worth in 2004, of which 43.1 percent, or US $ 1.95 billion, came from the EU). Through its imports, the Chinese T&C industry has contributed to the growth of other T&C activities worldwide. Such kind of dependence entails a long and stable
relationship with both developed and developing countries. Maintaining a delicate balance between herself and the developed countries will be a key challenge for China itself as more often trade relationships develop into a conflict because of certain unforeseen events like global financial crisis, volatility in the market, and surge in oil prices, etc.

Speedy and timely deliveries are an important element of competitiveness. China faces certain problems in this regard. There is a need to catch up with these supply constraints as world market will demand more and more customized products at faster pace. Besides, power shortages have considerably disrupted T&C production in China in the past. There are also bottlenecks in the transport and distribution infrastructure for locally produced and imported coal and oil. All these problems require immediate solution.

A major concern is China's "non-market economy" status at the WTO for 15 years (or upto 2016). China accepted this provision as a part of its accession. This poses adequate threat to its status of competitiveness as anti-dumping duties on T&C products from China can be higher than those from other market economy members of WTO like the ASEAN and several other developing countries. Again the transitional safeguard mechanism accepted by China as a part of its accession procedure valid until December 2013 will restrict its exports to other countries. Developed countries' imposition of this rule is a big drawback for China's future exports in this sector.

Another challenge China faces is in the area of imported cotton and raw materials. As the global financial crisis has reduced demand for products, imports of such material are curtailed, which in turn proves difficult to produce products for even domestic consumption. The Chinese government and textile producers are depending on the domestic market consumption rather than external demand. During January—October 2008, China bought 826,000 tons of cotton from the US; 570,000 tons from India; and 166,000 tons from Uzbekistan; which have come down by 18.8, 34.4, 15.8 percent respectively (Xinhua: 13 January 2009).

The Chinese textile sector export growth may decline during the present recession. The rising labour cost and decrease in demand will definitely affect its performance in
world trade (Zhu 2009: Personal Interview). From 1990s to 2007 end, the growth in textiles has been phenomenal. The Chinese products could capture large part of the world demand. With the onset of global financial crisis and significant rise in labour costs in textiles industrial clusters and in major cities, competitiveness of this sector is fast eroding. Countries like Vietnam, Indonesia, and Bangladesh will take advantage of this situation, because labour cost is still cheap in these countries and the developed countries can enter into better bargain with them in terms of bulk sourcing (Ho 2009: Personal Interview).

Many other trade experts also echoed almost similar views. China might lose its global competitiveness in T&C by 2015 because of the rise in labour costs. It will face sudden fall in FDI as most of the countries have started identifying Vietnam as a cheaper destination for growth of T&C in Asia (Song 2009: Personal Interview). It is a big challenge for China to maintain its dominance in world market. China must adopt the strategy of investing in great measure on R&D. Institutions like the National Innovation Center may upgrade innovation in the T&C sector. Chinese textiles sector has provided critical support to its rise in GDP growth in both the 1980s and 1990s. Even the growth has been significant after the dismantling of quota in 2005. During the first quarter of 2005, China’s export growth went up by 35 percent.

In response to such concerns, the Ministry of Textiles in China has drawn out certain plans to tackle this challenge. China should slow down its currency appreciation and increase export tax rebates to help lift its textile industry. The paper prepared by the Ministry of Information Industry, and based on recommendations from a range of bodies including the Ministry of Commerce, the China National Textile and Apparel Council (CNTAC), and the China Cotton Association (CCA) suggests certain recommendations. These include lifting the export tax rebate on textile products to 13 percent from the current 11 percent raising the tax rebate on garment exports to 15 percent from 11 percent cancelling of import duties for some textile machinery to help the industry increase efficiency in the face of rapidly rising costs and increasing labour costs by up to 40 percent in 2008 because of a new labour law. All these challenges pose serious concerns for the Government as it prepares to rejuvenate the industry in the aftermath of the global financial crisis.

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33 Policy Paper 2008 prepared by the Ministry of Information Industry, Beijing, China.
IV.2 Future Prospects

The T&C industry is based in the Eastern coastal region, the most industrialized area of China and the one which contributes significantly to the growth of national GDP. Zhejiang, Guangdong, Jiangsu, Shandong Provinces and Shanghai municipality are the five top exporting regions of China’s textiles representing 77 percent of the total T&C output. These provinces are constantly making efforts to invite more foreign investment which will step up their production activities to capture domestic market. The prospect is high in this sector as China is now concentrating on expanding its domestic base (Zhu 2009: Personal Interview).

Saturation in the traditionally developed market sometimes indicates a country with high potentiality to scout for partners to expand its exports and growth. Of late China has increased its collaboration with the Least Developed Countries (LDCs). It has provided to free market access for many products imported from those LDCs that have diplomatic relations with China. The T&C technical assistance programmes including training courses and technology transfers have been implemented in a number of LDCs. China is supporting international initiatives within the international financial institutions to provide further assistance to the LDCs and other developing countries to adjust to the quota-free trade regime.

China is also collaborating with other developing countries to upgrade their production and strengthen their competitiveness in the T&C sector. China’s foreign investment in the T&C industry has reached US $ 500 million mainly in developing countries. More Chinese enterprises are considering investing in other developing countries that benefit from low cost labour and duty-free access to major importing countries. In May 2005, the Deputy Minister of Commerce led a business delegation to Malawi, where it discussed investing in textiles and cotton industry and developing their industrial base and providing employment to the locals. By 2008, roughly US $ 6.5 billion were set to be invested and more than 1000 locals were to be employed.34

The Chinese Government has implemented a number of preferential policies with a view to encouraging its T&C manufacturers to invest more in other developing countries. These measures include preferential loans, simplified administrative

procedures, enforcement of legal rights, and enhanced information and intelligence support. China's overseas investment in the T&C sector is expected to grow faster in the coming years as mutually beneficial cooperation between China and other developing countries proceeds rapidly. China also expects that the competition in the sector will get tougher. It is planning to upgrade its products by moving into higher segments, i.e., manufacturing branded products. As most of the manufacturers are gaining experience and know-how through practicing original equipment manufacturing (OEM)\textsuperscript{35}, stronger enterprises are contemplating of designing and manufacturing branded products. There will be a shift from low and medium end to higher end products. China's strength lies in OEM (Guoxing 2009: Personal Interview).

It is generally argued that the textile and clothing firms in China will benefit from the reduction of import tariffs and the eventual elimination of export quotas (Zhang 2000: 123). The Chinese T&C sector will benefit from the WTO as China can import raw materials and machines at much lower tariffs, which will reduce the production costs and improve their competitiveness.

China's core competence in manufacturing especially in labour intensive products like T&C is well established. As a highly competitive producer and exporter of T&C, it is likely to have a great deal of influence both in expanding market access opportunities for these products and in defending against measures that would reduce developing countries' market access for these products (Martin and Ianchovichina 2001: 1209). However, the data provided by China Customs\textsuperscript{36} suggest that China's apparel exports consisting of HS Codes 61 and 62 registered higher exports to the US reaching US $ 1.67 billion in 2007. But, in 2008 the export value has come down marginally to US $ 1.63 billion. This sudden decrease in exports may indicate the effect of the current global financial crisis. Experts believe once the impact of the global crisis is over, China will be able to improve its export prospects as it has competitive advantage in the sector.

\textsuperscript{35} OEMs are manufacturers who resell another company's product under their own name and branding. It refers specifically to the act of a company rebranding a product to its own name and offering its own warranty, support and licensing of the product. The term is really a misnomer because OEMs are not the original manufacturers; they are the customizers.

\textsuperscript{36} Calculated from the World Trade Atlas Online Database (Data provided by the Governments of different countries; in the case of China it is done by the China Customs.)
IV.3 Impact of American\textsuperscript{37} Financial Crisis

The US sub-prime crisis that broke out in the summer of 2007 had an adverse impact on the global economy after the bankruptcy of Lehman Brothers and General Motors in September 2008. Bankruptcy of these established institutions followed by acute liquidity shortage and credit crunch snowballed into a worldwide economic slowdown. The US, the Euro Zone and Japan all slipped into recession in 2008. The emerging countries have faced not only a dramatic decline of economic growth but also a surge of capital outflows. China’s embrace of openness coupled with the inexorable forces of globalization has meant that their economies are now deeply interwoven into the global economy (Naughton 2007; Panagariya 2008).

Given these processes, China’s economy will remain vulnerable. As external trade in merchandise and services contributes to a significant portion of its economy, a global slump in demand will have a negative impact on China. A study conducted by the World Bank (2009) projects that the world GDP growth would 2.5 percent in 2008 and 0.9 percent in 2009. Developing countries would likely to grow by 4.5 percent the following year, down from 7.9 percent in 2007 whereas growth in high-income countries would turn negative. With world trade volumes projected to contract 2.1 percent in 2009, countries will experience big drops in their exports. Moreover, sharp declines in consumer spending and unemployment in the US because of the financial crisis may result in dramatic reduction in exports from China. The US, the EU and Japan which account for 46 percent of the external demand for China’s exports have all slipped into recession due to the impact of the American financial crisis.

Emerging markets such as Hong Kong, Taiwan, South Korea and the ASEAN countries which are China’s major export markets have also slowed down dramatically (Xiangshuo 2009: Personal Interview). As a result of the weakening external demand, China’s exports have declined significantly. Both exports and imports have registered a contraction since November 2008. Due to the impact of the American financial crisis a large number of export-led private enterprises in China’s

\textsuperscript{37} Though popular parlance suggests it to be global financial crisis, in the thesis we emphasize it to be American, because it originated there as the real American sub-prime mortgage realty crisis. The crisis of course later became global in nature and took the shape of global financial crisis. It also came to be known as global economic crisis as global economic and trade activities were intricately related to global finance.
coastal provinces, especially in Pearl River Delta dealing with textiles sector have gone bankrupt (Song 2009: Personal Interview). Around 20 million unskilled workers lost their jobs. Furthermore, the slowdown in China’s exports along with the decline in real estate investments has led to a decrease in GDP growth from 13 percent in 2007 to 9 percent in 2008.

Therefore, the Chinese government has accorded priority to the export growth with the intention that the export sector can accommodate excess labour. The huge number of workers released from bankrupt or poorly operated enterprises has caused a surge in the real unemployment rate which could lead to social unrest. Hence, the Chinese government has continued to provide tax rebates to export goods, increasing its intervention in the foreign exchange market to prevent further appreciation of the RMB against the US dollar and lowering its environmental and energy-consuming criteria even during 2008 (Zhang 2009: Personal Interview).

Despite these measures, exports of textiles have been hit. China’s textiles firms’ profit declined for the first time in ten years. This sharp fall in profits is due to the decline in overseas demand. The National Bureau of Statistics in China says that the decline is about 1.77 percent over 2007. The losses for the textile firms added up to 22 billion Yuan from January to November 2008. The causes were sharply noticed during this period when the financial crisis began impacting the world economy.

Cotton, a major component of China’s textile production, witnessed a decline in its imports during first ten months of 2008. Global financial woes had depressed the import demand. According to the General Administration of Customs between January and October 2008, China imported 1.866 million tons of cotton at a combined value of US $ 3.11 billion, a decline of 8.3 and 10.1 percent respectively for the same period of 2007. The imports of SOEs and FIEs stood at 508,000 tons and 369,000 tons respectively down by 14.5 percent and 18.4 percent on a yearly basis (Xinhua: 13 January 2009).

As the American financial crisis prolonged, China's textile industry is under dual pressure from weakening demand at home and abroad. The growth rate of China's textile exports began to decelerate in 2008. According to statistics provided by the General Administration of Customs, China exported US $ 185.17 billion of T&C in
2008, up 8.2 percent from the previous year. However, the rate of growth was down by 10.7 percentage points from that in 2007. The Government expected the growth rate of China's overall textile exports in 2009 to continue to slow down as the economy also began to get affected by the rising labour costs, the appreciation of the Renminbi, and reduced demand in major export markets.

In addition, after a period of transition following the textile integration in 2005, the potential of exports of relevant products have already been fully released. As anticipated, no sharp increase is expected in exports of Chinese textile products that had been under bilateral textile agreements with relevant countries. However, the Government and industry sources feel its textile industry and its major trade partners in the world market would find ways to complement each other's advantages and improve their interdependence. China has bounced back previously in such crises. Now it is an opportunity for China to look for other markets as well as create demand at home. The Central Government is paying adequate attention to this problem. Other trade experts also believe that China's textile trade with other countries after 2010 would see a stable and healthy development.

Since the third quarter of 2008, China's textile industry has encountered pressure from declining demand both in the domestic and international markets as the country's real economy began to feel the negative impact of the spreading international financial crisis. During the 104th China Import and Export Fair, the contract value in textiles dropped by 31.5 percent compared with the previous fair. Enterprises are feeling the pressure. The number of enterprises that stopped production and went bankrupt in the last two years has increased. Large-scale textile enterprises in China experienced negative growth in employment and small and medium-sized enterprises recorded serious downsizing.

This is also reflected in the data provided at Figure 2. Though in volume terms China's exports to the world have gone up (Figures 1 and 3), yet annual export growth rate has witnessed a significant decline. China's annual export growth rate to the world has dramatically come down from 21 percent in 2007 to 6 percent in 2008. The

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38 From the discussion held at a business meet organized by CII and Embassy of India, Beijing at Marriot hotel in Beijing on April 15 2009
year 2009 has witnessed even much lower growth rate as it reached a negative growth rate of 10 percent (Figure 2 and Appendix II). Similarly China’s annual export growth rate to the US has substantially come down from 16 percent in 2007 to 0 percent in 2008. China’s performance in Hong Kong and South Korea has also been affected significantly. It has witnessed a negative growth of 18 percent and 8 percent in 2008 and 2009 respectively in Hong Kong and negative growth of 1 and 31 percent in 2008 and 2009 in South Korea (Figure 2 and Appendix II). This huge decline has taken place due to the impact of global financial crisis on China’s trade.

IV.4 Strategy to Counter the Impact

The global financial crisis is both a challenge and an opportunity for China. Although the crisis is affecting its exports, employment, and foreign exchange reserves, it is also generating external pressure for China to carry out further structural adjustments and provide a window of opportunity to expand overseas investment. The Chinese government tries to utilize this opportunity not only to sustain short-term economic growth but also to achieve long-term strategic objectives. To stimulate short-term economic growth and to speed up structural reforms, China should diversify its domestic demand and increase household consumption as the top priority. The most effective way to boost consumption is to increase household income (Zhu 2009: Personal Interview). Xue Lei is of the opinion that current global financial crisis is an opportunity for China to showcase its strength in the textiles sector. Being a manufacturing hub in T&C products especially in low and medium range, China should move higher up in the production by producing and designing high-end products. It must invest more and develop skills to produce domestic high end products for world market (Lei 2009: Personal Interview).

As unemployment in textiles sector is rising, to mitigate the problem the Central Government should not over-emphasize the policy of export growth. Rather, it is time for the Government to look at the services sector as an immediate alternative to minimize this social crisis. It should devise policies to strengthen services sector by opening it up to the outside world in a regulated manner (Yong 2009: Personal Interview).
However, the government is keen to take immediate measures to provide stability to the sector because it believes that it has enough potentiality to remain as an engine of growth (Ho 2009: Personal Interview). In that direction, China's State Council recently unveiled a detailed three-year support plan for the textile industry. It is of the opinion that the plan is aimed at ensuring stability in the industry and upgrading its structure. The plan is geared at rejuvenating the industry. The annual production of large textile enterprises (with annual revenue of more than 5 million Yuan) is expected to increase by 10 percent year on year. If the plan is carried out with meticulous implementation strategy, the annual output of such enterprises will rise to 1.2 trillion Yuan by 2011 from 812.6 billion Yuan in 2007 and 850 billion Yuan in 2008.

The Government is also planning to develop state-of-the art technology, reduce energy consumption and increase efficiency in the textile industry. The Government is also determined to provide higher export tax rebate rates for textile products. China has raised the export tax rebate rate for textiles, five times since August 2008, to help textile makers cope with stagnant demand. The most recent increase, announced in April 2009, took the rate from 15 percent to 16 percent. The Government will also grant preferential loans to the exporters and enterprises and will exempt import tax on inputs. Since January, China has announced stimulus plans for 10 major industries including textiles vehicles, steel, shipbuilding, machinery, electronics, and information technology (Xinhua: 2009). Major incentives like these are extremely important to raise the morale as well as future prospects of these exporters who have been in this trade for so long (Zhu 2009: Personal Interview).

V Summary

The Textiles sector in China has been regarded as one of the pillar industries. Its role in the economy is well recognized in terms of its contribution to GDP and domestic employment. With the opening up of China and onset of globalization, the sector found huge opportunities in terms of its export prospects. Since then the Central Government has accorded priority to this sector as one of the potential sectors for export promotion. Cheap labour cost, attractive FDI policies, developing an industrial cluster approach and meeting the low and medium range global demand of products have been the hallmarks of China’s rise in world’s T&C market.
Though the world trade in T&C remained restrictive in nature, under the MFA regime, China performed significantly better compared to other developing countries. Due to the abundant supply of cheap labour with regular infusion of technology, China could register high export growth in the world market in the 1990s. After joining the WTO it continued to increase its share until the transitional safeguards were imposed in 2005 by the US and EU. This provision was targeted at China specifically to curtail its prospects in textiles trade as developed countries were convinced about the comparative advantage China has in the sector. Only during 2005 and beginning of 2006, China’s exports received a temporary jolt but soon they picked up. It continued to accelerate its exports and share in global market during 2007 until the global market in textiles experienced the slump caused by the global financial crisis in the third quarter of 2008.

China’s textile firms’ profits declined for the first time due to reduction in overseas demand. The growth rate of China’s overall textile exports in 2009 continued to slide as the economy also began to be affected by rising labour costs, the appreciation of the Renminbi, and reduced global demand in major export markets. Moreover, sharp decline in consumer spending and growing unemployment in the US will further result in the deceleration of exports from China.

To minimize the sudden impact of the crisis the Chinese Government has taken a series of measures such as stimulus package, widening of domestic demand base, creation of own brands, locating new markets, and automation of the textiles industry which are also the immediate priority for securing the revival of the industry. China believes that such crisis can always be treated as opportunities. China would be able to retain its global competitiveness as it is a huge country and its labour costs vary greatly from region to region. This would mean that textile and clothing exports will remain competitive and important for some time to come in the future as long as production is able to move to lower-cost areas or labour can freely move to the coastal areas.

Sectoral analysis of textiles sector has provided a broad overview of how China has taken necessary steps to integrate its sector globally and prepared itself domestically. This sectoral approach is also employed in the telecommunications sector to locate its
position in the world and analyze how it has evolved after China has joined the WTO in the following chapter.