"The National Council of Textile Organizations has been rallying foreign governments to pressure the United States, seeking various ways to impede Chinese trade. With all of the uncertainties and concerns expressed in different countries about what free trade in textiles and clothing would mean, quotas might be extended one more year." On 20th, September, 2008, Doctor Elliot J. Feldman of Baker & Hostetler LLP Washington, D.C. delivered a speech on International Trade and the End of Textile Quotas in Zaozhuang•China Knitting Industrial Innovation and Development Forum.

International Trade and the End of Textile Quotas

Thank you for inviting me to speak to you today. I am honored to join you for this celebration of some of your accomplishments.

You are justly celebrating. Not so very long ago, China was impoverished and hundreds of millions of people had little in the way of clothing. Your industry helped raise these hundreds of millions from poverty to prosperity, and although China is still a developing country, one of the great benchmarks of development has been achieved because of you.

There is, unfortunately, both good news and bad news in your achievement. The good news is that you harnessed your skills and resources to clothe the poor as well as those already more prosperous. You met the first challenge, which was simply to produce more clothing. The bad news, however, is that you began to produce too much, and you were criticized for making cheap clothing of questionable quality. Wisely, you converted that bad news into good, exporting the surplus and earning foreign currency for China. You also improved the quality of your product. Then came bad news again, for your success led to trade imbalances and efforts of other countries to restrict your exports. You were challenged to make the clothing more stylish and competitive, and your success became more dependent on exports. Now the Government in Beijing is challenging you to make clothing without polluting the environment. Each step has presented a new challenge. So far, you have risen to meet every one of them.

I am addressing you now, in September 2008, because, as you all well know, the international quotas on textiles and apparel are coming to an end in just three months. This change in the international trade of textiles and apparel is your newest challenge. The Multifiber Agreement that has restrained trade in textiles since 1974, and its various extensions, finally are over. This is a time for you of great hope and opportunity, but also of great risk. I had thought that, with all of the uncertainties and concerns expressed in different countries about what free trade in textiles and clothing would mean, quotas might be extended one more year, but I am now not so sure. In my view, you must be prepared for the very strong possibility that quotas will not be extended, that in theory there will be free trade, and that Americans and Europeans, in particular, will initiate trade remedy actions against textiles and apparel from China that potentially will do great harm to your industry.

Trade actions in one country almost always lead to actions in other countries, so that while I am going to talk about the United States, there are implications for Canada, Europe, Mexico, Australia, Brazil – indeed, all other countries where your shipments with restricted access to one major market might be redirected into other markets. I note, too, that the actions that could be taken all derive from the same organic international law of the WTO. Although I will be focusing on the United States, the principles apply to actions that could be taken by any of your trading partners.

You must appreciate that the expiration of the quotas comes at a very volatile time, especially in the United States. We will elect a new Congress, and a new President, on November 4. Sentiment in the Congress already today is very hostile toward China, and that sentiment will grow much stronger – guaranteed – after the election. Senator Barack Obama, for example, who may well be elected President soon, has been very critical of China on workers' rights, government subsidies, intellectual property rights, currency manipulation, product safety, and environmental degradation. But he has also said, "America and the world can benefit from trade with China," and, "Seeing the living standards of the Chinese people improve is a good thing – good because we want a stable China, and good because China can be a powerful market for American exports." Senator McCain has expressed similar serious reservations about China. Congress will sympathize with the U.S. industries in textiles and apparel, both to protect them and because of the kinds of criticisms Senator Obama has summarized.

Unlike the political systems in most countries, in the United States we have what we call a "balance of powers," which means the President does not control everything alone; he must deal with Congress, and Congress, unlike parliaments in most countries (or the National People's Congress), does not

Doctor Elliot J. Feldman of Baker & Hostetler LLP Washington, D.C.

have to do what the President wants. Very often, it refuses, or does something else. Moreover, trade disputes go first to the United States Department of Commerce, and although the Department of Commerce is a branch of the President's office, it is politically very responsive to Congress. It is safe to predict, I think, that the United States will remain favorable to trade with China after the election, but the Department of Commerce will do what it can to help and protect U.S. industry.

The end of the quotas will not necessarily mean the beginning of free trade because there are many tools available to inhibit free trade even when there are no official or formal restrictions. Many of the protectionist forces that have maintained quotas for thirty-five years are still with us. And, for a number of reasons, some relevant to trade in textiles and clothing and many not, China is at the center of concerns expressed, especially in the United States and Europe, but also in Canada and Mexico and India and throughout the Western Hemisphere. Whereas Mexico has recently been China's leading competitor in the United States for the sale of clothing, Canada has been the leading foreign supplier of textiles.

I am going to talk more about clothing than textiles, both because that is the business most of you are in, and because of the circumstances of trade that I will explain later in my presentation. The key facts: in 1990, Hong Kong was the principal foreign supplier of clothing to the United States with 16.1 percent of the market. China was second with 14.5 percent. No country had a dominant share. By 2007, China alone held 33.4 percent of the market and no other country had more than 7 percent.

There is widespread fear, in the United States and elsewhere, that, with the end of quotas, China will swamp world markets. American companies will not be able to compete, and foreign companies will not be able to compete in the U.S. market against imports from China. China, many believe, has virtually unlimited capacity and virtually no bottom to its cost of production because of abundant and cheap labor and government subsidies. In no other industrial sector is the fear greater in the United States, nor from any other country.

These concerns are acute for some specific products more than others. Reviewing statistics from 2006 to 2007, for example, in those Chinese products of greatest concern to you in this audience, China increased U.S. market share most dramatically in cotton and man-made knit shirts and blouses for women and girls; in cotton socks and stockings (surpassing Mexico quickly and substantially); in socks and stockings made from man-made fibers; men's and boys' cotton and man-made fiber shirts; women's and girls' cotton trousers, slacks, and shorts; brassieres; man-made fibers bras; cotton and man-made fiber underwear; cotton terry and other pile towels; cotton sweaters (from 28 percent of the market to 54 percent in one year); men's and boys' man-made fiber sweaters; women's and girls' man-made fiber sweaters (from 38 percent to 51 percent in one year); women's and girls' man-made fiber slacks, breeches and shorts. This list is not exhaustive, and is not meant to be all-inclusive. It is no guarantee that products not on the list are not performing in the market in 2008 such that they would be. But, generally, China's market share in these products has grown so quickly, or has become so dominant, as to raise to a probability trade action against them.

And there are some textiles that have seen similar growth in the

U.S. market, particularly polyester filament fabric (from 10.84 percent to 17.16 percent in one year; or knit fabric, from 8.38 percent in 2006 to 11 percent of the market in 2007). In every instance, a legal investigation will inquire as to whose market share has been eroded. In most of these cases, Mexico is losing out to China. To the extent market share is lost by foreign competitors and not by U.S. companies, the Chinese manufacturers ought to fare well in a trade dispute, but you should know where the greatest vulnerabilities seem to be.

In my view, the long-term threat from China in most instances is doubtful. Costs, especially for labor, are rising quickly in China. Manufacturing is moving to Vietnam and Thailand, to Indonesia, even Bangladesh, all now lower cost countries. Outsourcing from the United States is in decline, in parts due to rising transportation costs and the strengthening RMB. The U.S. market is becoming less attractive for China because of the weakening dollar. The Chinese Government's policy is to slow down growth, especially in manufacturing. But it is the lasting impression, and the most immediate shifts in market presence, that count.

The National Council of Textile Organizations has been campaigning hard against the perceived dangers of a surge in Chinese exports to the United States after quotas end on December 31. It has been rallying foreign governments to pressure the United States, seeking various ways to impede Chinese trade, above all, but also particularly trade from Vietnam. Its most willing and first ally is Mexico, but just last week it obtained signatures from sixteen foreign countries on a letter to Congress urging congressional support for actions against Chinese goods. Mexicans, especially, not only fear Chinese imports themselves in the Mexican market, but also see their market share in the United States being displaced by China.


He paid a visit to a local factory in Zao Zhuang, Shandong Province

Americans think that the Chinese Government ultimately controls all state-owned companies and can make sure they do not fail by subsidizing them, in many different ways, including special tax breaks, favorable loans and other concessions. Americans think China does not really have private enterprise, and that even private companies are heavily subsidized in sectors chosen by the Chinese Government for success. Americans think Chinese labor is underpaid and exploited to maximize production, and that the environment in China is forsaken for the same purpose. These criticisms are amplified by the rapid growth of exports, and contribute to the probability of trade actions.

Threatened Trade Actions

Knowing that your businesses are in danger, what can you do? It is possible that quotas will be extended. You should not necessarily hope for that outcome, because it would only delay again your ability to grow your businesses and trade more with the rest of the world. The National Council of Textile Organizations wants a special monitoring system, as already exists for Vietnam, but there does not appear to be congressional support for funding it, and there is considerable opposition to it, mostly from American retailers and importers of Chinese-made goods. The most likely outcome, therefore, will involve trade remedy actions, which come in three principal forms – safeguards, antidumping, and countervailing duties. There are some things you can do in anticipation of these possibilities.

Safeguards

First, as to safeguards. It is not necessary in international trade to do anything wrong and still be penalized. Safeguard actions permit countries to restrict your exports simply because you suddenly ship too much, creating a "surge" of foreign goods entering a market. You do not have to be dumping (which I will explain in a moment). You do not have to be receiving subsidies from government. However, safeguard actions are rare precisely because you are vulnerable even without having done anything contrary to the international rules.

The special safeguard provision to which China agreed when it acceded to the WTO makes it easier to mount a safeguard action against China than against any other country, and action can be brought against China without implicating the products of other countries. Otherwise, most-favored-nation principles apply to safeguards: the products of all countries must be treated the same way. Nevertheless, whether for China or for everyone else, safeguards ultimately require presidential approval.

There have been very few safeguard cases during the last twenty-five years, and even fewer that have been successful. Four have been brought against Chinese products since the special safeguard was instituted; the President refused, every time, to act on the recommendation of the International Trade Commission, which is the first agency to hear a petition for safeguard action. This presidential policy was not necessarily special for China, however. President Reagan had declined to act on any safeguards brought to him as well during the eight years of his presidency. President Bush did impose restrictions on steel under the safeguard provisions, from several countries, and the recovered steel industry in the United States insists the safeguards were keys to making the domestic industry competitive again. It is for this kind of reason that safeguards, despite being unusual, are always a threat – because they have been considered effective in helping U.S. industries.

Safeguard remedies can take many forms, including quotas, tariffs, and tariff-rate quotas. The United States International Trade Commission proposes remedies intended to provide all the protection a domestic company may want or need, but for a limited time.

Quotas, such as those expiring on textiles, have been designed chiefly to make safeguard actions unnecessary. Take away the quotas, and instincts run toward safeguard complaints to restore them. However, safeguards are temporary. They require the domestic industry in the United States to adjust over a period of no more than three years to the new competitive conditions indicated by the surge, and learn to live with the greater volumes of foreign merchandise. The domestic companies can change their product lines or go out of business or find new ways to compete, but the burden of adjustment falls on them.

By contrast, antidumping and countervailing duty actions impose duties on foreign products for five years, but it is not uncommon for them to be extended. Those duties can be prohibitive. They also require annual investigations, called "administrative reviews," which are very onerous and expensive for foreign companies.

Dumping

You mostly are familiar, probably, with antidumping, which is essentially a claim that a foreign company is selling its products in the United States at an unfairly low price. It has long been the protectionists' weapon of choice, and it is particularly lethal against non-market economies. The Government of the People's Republic of China is trying hard to get the United States to recognize China as a market economy, which would make a big difference in antidumping cases. However, I do not think such recognition is coming any time soon. The difference it would make is that, currently, when the United States Department of Commerce asks what it costs to manufacture something in China, it values the inputs based on prices outside China – often in India or Indonesia, sometimes in Africa – because it says prices in China have no meaning because there is no market. Reliance on prices from other countries – "surrogate values," they are called – virtually guarantees finding dumping because the Commerce Department has so much discretion in calculating costs.

Dumping, in principle, does not involve the Chinese Government, although because of the prevalence of state-owned enterprises foreign trade authorities often believe the Chinese Government is involved even when officially it declines to be. Companies set prices, and dumping is based on a theory that a company may not sell a product abroad for less than it sells it at home, or for less than it costs to make. This theory assumes that manufacturers make too much of something and have to sell off the surplus, or they are trying to corner a foreign market by underselling competition, hoping to put the domestic competition out of business so that they can later raise the price. It does not matter, however, what you may have intended; it matters only that you are found to be dumping. When dealing with non-market economies where the Commerce Department has so much discretion to assign surrogate values, dumping is not hard to find.

Subsidies

Countervailing duties are imposed where illegal government subsidies are found. However, not all subsidies are illegal or countervailable, subject to being offset by duties. The WTO rules exempt certain subsidies from countervailing duties, and it is possible to tailor certain social programs to conform to those WTO rules. Unfortunately, to date, the Chinese Government has not designed programs with WTO rules in mind.

This area of law has been applied to China by the United States only during the last two years. The theory behind subsidies is that when a government directs money to a company or industry, it distorts the market, which in principle should be free of government influence. Governments may provide such subsidies in order to help corner a foreign market, or to help a particular domestic industry, or to serve broader and legitimate social policies. In some instances, a government might consider a particular industry essential for the well-being of the country, and so will assure its success and prosperity through subsidies. Textiles in China have long been considered an essential industry and have been the subject of national, provincial, and local planning. But again, it does not matter why; it matters only that a company receives financial benefits from government.

The United States has investigated subsidy allegations against China in a dozen cases. The Commerce Department has found countervailable subsidies every time. The Chinese Government, so far, has not appealed the agency's determinations to the U.S. courts in any of these cases, and instead has taken its views to the WTO. In three of the cases in the U.S. so far, private industry, but not the Chinese Government, is appealing. The absence of the government in these appeals is, in our view, a problem, and there are many risks as to how these cases will be decided and what precedents might be set.

(to be continued)