



# Free Trade Bulletin

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## Cutting the Cord: Textile Trade Policy Needs Tough Love

by Daniel Ikenson, policy analyst, Center for Trade Policy Studies, Cato Institute

### Introduction

On January 1, the quota regime that had governed international trade in textiles and apparel for more than 30 years finally came to an end. Final implementation of the Agreement on Textiles and Clothing<sup>1</sup> marks the termination of one of the most pervasive and ill-advised government interventions in the post-war international trading system and hails the restoration of conditions under which market competition has a chance to flourish.

But not everyone is embracing this historic liberalization of trade. U.S. textile producers opposed the ATC—and even did their part to subvert it. When it became clear that the final phase of the ATC would be implemented on schedule, the industry turned expectantly to the administration for some measure of recompense. With less than two months to go before last November's election, the Bush administration gave the industry the green light to file safeguard petitions against Chinese imports on the basis of a "threat" of market disruption—a threshold much lower than the "actual" market disruption required by law and WTO agreement.

After a U.S. court intervened in the matter, enjoining the government from proceeding with any threat-based sanctions, U.S. officials began suggesting that China do something to regulate its exports, as China's "impact on world trade is changed," and that "there is an obligation that goes along [with its new role]."<sup>2</sup>

Meanwhile, the fate of the U.S.-Central America-Dominican Republic Free Trade Agreement (CAFTA-DR), the most important trade matter on the administration's 2005 agenda, remains uncertain. Negotiations on CAFTA-DR were concluded last summer, but the deal has yet to be presented to Congress for a vote because the administration is trying to overcome opposition from, among others, certain domestic textile producers. Failure to pass this agreement would constitute a monumental setback for regional integration, and could throw prospects for the Doha Round into further doubt.<sup>3</sup>

The time has come for the Bush administration to cut the textile lobby's cord. For years, the industry has been a thorn in the side of policymakers attempting to do the right thing by liberalizing trade. Trade agreements and other trade liberalizing initiatives have had to be abandoned, curtailed, or saddled with red tape to accommodate the industry's unwillingness to compete. Years of capitulation to its demands have bred a sense of entitlement to protection rather than a commitment to move away from the federal dole.

Despite years of excuse making and exception seeking, and the tremendous costs of textile protection, the industry fails to acknowledge the sacrifices made on its behalf. It demonstrates no contrition for saddling U.S. consumers with stealth taxes and dragging down market prospects for other industries, instead continuing to rely on threats and extortion to achieve its objectives.

That strategy has run its course. Decades of use have devalued, if not exhausted, the industry's political leverage. President Bush won reelection in textile states resoundingly and Rep. Jim DeMint (R-SC) won a Senate seat in South Carolina handily, running on a pro-trade message. The administration can win passage of CAFTA-DR without kowtowing to the textile lobby, as it felt was necessary to win passage of its trade promotion authority legislation in 2002. It's time for the president to demonstrate his commitment to freer trade with some tough love for the textile industry.

### Exceptions and Deceptions

What began in the 1950s as a targeted effort by the United States to restrict imports of cotton fabric from Japan gradually expanded to cover more products from more countries, as production capacity proliferated around the world. By 1974, the quantitative restrictions ballooned into a mammoth program of restraints known as the Multifibre Arrangement (MFA). The MFA instituted rich-country (U.S., EU, Canada, and Norway) quotas on imports from developing countries—an injustice that distorted production, forced

importers and retailers into inefficient and convoluted supply arrangements, transferred resources from U.S. consumers to foreign quota holders, and imposed a stealth tax on clothing purchases at the cash register.

The justification put forth in defense of this restrictive regime was that the industry needed time to adjust to the new realities of international competition. But adjustment was not forthcoming. Rather, the quotas were expanded as world supply increased and prices fell in response to new production in unrestricted countries.

By the start of the Uruguay Round in 1986, developing countries were united in their desire to end the MFA. Once again, the textile industry prevailed upon negotiators that it needed time to adjust to the new realities of international competition, and that immediate abolition of the quotas would overwhelm any hopes of an orderly adjustment.

Thus, by the conclusion of the round eight years later, the ATC emerged, stipulating a four-stage phase-out of the quotas over a 10-year period.<sup>4</sup>

While the developing countries were pleased with the agreement, in hindsight they erred by allowing the rich countries to determine which products would be liberated from quota in which stage. Many of the products liberalized by the United States during the first two stages—in 1995 and 1998—were never even subject to quotas in the first place.<sup>5</sup> While the United States could claim fidelity to the letter of the agreement, U.S. deception undermined its intention. And by deferring most liberalization until the final stage of the ATC (January 1, 2005), textile producers failed to capitalize on the “gradual adjustment” potential it claimed it needed. Thus, policymakers should reserve empathy and discount the industry’s persistent projections of imminent, massive job losses in the industry.

Protectionist policies have not stopped the decline of textile and apparel employment. Trade is but a small contributor to the job losses experienced in these industries. Rather, the most likely culprit for job loss is increasing productivity. While textile spokesmen like to point to the industry’s increasing efficiency as a reason why U.S. producers should be able to compete with anyone in the world—on a proverbial “level playing field,” of course—these same figures explain declining employment in the industry. Between 1980 and 2000, U.S. textile and apparel industry employment declined by 35 and 50 percent, respectively. But over this same period, productivity increased by 111 and 115 percent in the textile and apparel industries, respectively.<sup>6</sup> Thus, in 2000 it was possible to produce the same amount of output as in 1980, but with less than half the amount of labor.

While protectionist policies have not saved jobs, they have especially hurt lower-income American families, who spend a larger portion of their budgets on clothing expenses. And clothing that lower-income families are more inclined to purchase—those made of cotton or man-made fiber—are systemically subject to higher tariffs than their silk equivalents, which are more likely to be purchased by wealthier consumers.<sup>7</sup>

Thus, when Congress supports the efforts of an industry to secure import protection in the name of preserving domes-

tic jobs, not only are the jobs unlikely to be saved, but the looting of a single mother’s pocketbook is sanctioned.

### **Fabricated Excuses—Protectionism is Addictive**

The textile lobby defends its protection seeking with claims that foreign markets are closed or that foreign governments unfairly subsidize their own textile and apparel industries. Yet a review of the trade statistics reveals not only that U.S. textile exports appear to be unhampered, but that they have been phenomenally successful in recent years.

Between 2001 and 2004, the value of overall U.S. commodity exports increased by just over 10 percent.<sup>8</sup> Meanwhile, the value of U.S. exports of textile products increased by over 27 percent during the same period.<sup>9</sup> Perhaps most remarkable, however, is the success U.S. textile exporters have had cultivating a market in—of all places—China. U.S. exports of textile products to China increased by well over 600 percent during this same period, from under \$300 million in 2001 to a projected \$2 billion in 2004.<sup>10</sup>

Those figures contradict the textile industry’s rendition of reality. Quite interestingly, most of the export growth to China occurred after implementation of the third stage of the ATC. The third stage was really the first to feature any real liberalization in clothing trade, and as China responded by ramping up its clothing production, demand from its apparel operations for textile inputs simultaneously shot up. The U.S. textile industry is thus a significant beneficiary of quota liberalization—a conclusion it appears keen on downplaying.

The textile industry is simply not interested in competing. Foreign barriers—real or imagined—have been an excuse it has used with success to get the U.S. government to respond favorably to its special requests. When U.S. Trade Representative Robert Zoellick unveiled a proposal in 2002 to eliminate industrial tariffs by 2015—an idea that would seem to remedy the textile industry’s concern about foreign market access—a spokesman for the American Textile Manufacturing Institute said the plan was “an outright gift to China—one which will come at the expense of U.S. textile manufacturers and workers, and our potential export markets in the Western Hemisphere.”<sup>11</sup>

Another fact the industry prefers to downplay is that apparel production is only one of many applications for textile products. By some estimates, over two-thirds of textile mill output is used for applications other than apparel manufacturing.<sup>12</sup> Among the textile industry’s customers are firms in industries as diverse as aerospace, automotive, medical, furniture, and civil engineering. According to the findings of an OECD study on the world’s textile industry, “the non-clothing applications of textiles or the so-called ‘technical textiles’ are now more important than clothing applications and account for the fastest growing segment of total textile production within developed countries.”<sup>13</sup>

But the U.S. industry has been successful pursuing protectionism in the past and, until it is firmly rebuked, will continue down that path. In the run-up to the final implementation of the ATC, the U.S. textile industry lobbied for more protection. Having failed to convince the U.S. government and other WTO member countries to agree to prolong

final implementation of the ATC, the industry turned to the China textile safeguard. Under a bilateral agreement that paved the way for China's accession into the WTO, the United States can re-impose quotas on Chinese textile and apparel products if a surge in imports causes domestic market disruption. If those conditions are met, import growth can be capped at 7.5 percent of the previous year's volume. In 2003, the industry was successful in winning such restrictions against Chinese-made brassieres, dressing gowns, and knit fabric, all products that were removed from quota in the third stage of liberalization in 2002.

The rationale behind the textile industry seeking sanctions against Chinese clothing—which it does not produce itself—is that restrictions against China could leave more of the U.S. clothing market open to Caribbean, Central American, and other producers, many of which purchase textile inputs from U.S. firms.

In September (i.e., two months before the U.S. elections), Grant Aldonas, a U.S. undersecretary of Commerce, announced to news reporters that quotas could be re-imposed against China even without a surge in imports—simply the threat of market disruption would be enough. Textile producers promptly filed nine “threat-based” petitions seeking quotas on products like trousers, shirts, and underwear—all products still subject to quota and thus by definition not surging.

But in early December, the U.S. Association of Importers of Textiles and Apparel filed a lawsuit with the U.S. Court of International Trade, seeking an injunction to stop the U.S. government from imposing quotas in those cases on the basis that accepting “threat-based” petitions violated the government's own published rules. In late December, the court issued an injunction, prohibiting the government from considering further the petitions in question and precluding it from accepting any new “threat-based” petitions. The court is expected to have a full hearing of the case in March, but in the meantime, the textile industry's plans to further restrain Chinese clothing imports have been dealt a setback.

The court's injunction deprives the administration of a means to bestow favors upon textile producers—something it may feel it needs to do to overcome their opposition to CAFTA-DR, for example. But Commerce Secretary Donald Evans and Undersecretary Aldonas met with Chinese officials this month to discuss textile trade issues. There is some speculation that U.S. officials are attempting to persuade China to voluntarily restrain its textile and apparel exports. Having broken no rules and without the U.S. threat of any WTO-legal sanctions, China is not obligated to engage in any such self-restraint. Thus, any measures China may invoke to limit its exports would likely be seen as a favor or gesture of goodwill to the United States (i.e., something to be reciprocated).

The administration has accumulated significant political capital with respect to China by refusing to indulge every protectionist whim to thwart Chinese imports during its first term. But it would be unwise for the administration to squander that capital over an issue wherein the United States does not occupy the moral high ground, and on behalf of an

industry that, by any reasonable measure, has exhausted all of its entitlement to special consideration and goodwill. Demands of China should be reserved for issues that concern broader U.S. interests, such as intellectual property rights enforcement and further liberalization of China's services industries. Such capital should not be expended on behalf of an industry that continues to undermine prospects for the administration's trade agenda.

### **The Last Straw**

Last summer, negotiators from five Central American countries, the Dominican Republic, and the United States concluded negotiations for a free trade agreement. The agreement would liberalize trade in the region, benefiting American families, manufacturers, and farmers. It would inspire a better allocation of resources and improve prospects for wealth creation. And it would lock in economic and political reforms made in a region that was only recently mired in civil war and despair.

But CAFTA-DR is not perfect. Among other restrictions are rigid rules used to determine whether a product originates in the region—a necessary qualification for duty-free access. These rules are particularly cumbersome where textile and apparel trade is concerned. At the behest of the U.S. textile lobby, the agreement includes “yarn forward” rules of origin, which essentially require the final clothing product to comprise of regionally made textile components. (Since the United States is the only country within this group that has significant textile production, “regional” is virtually synonymous with U.S.). Inclusion of these rules was likely accomplished at the expense of other items being taken off the table, such as better U.S. access for other products or services. Ultimately, the agreement contains yarn forward rules of origin, with some minor allowances for third-country textile components in some cases.

But those minor exceptions were apparently enough for some textile producers to suddenly oppose passage of the agreement.<sup>14</sup> If this opposition translates into legislative opposition from textile-state representatives, the administration must find a new strategy to attract the necessary votes to pass it. How can these producers really oppose an agreement that gives their natural customers access to the U.S. market on terms preferable to those under which Chinese and Indian producers will export? Without CAFTA, the Central Americans and Dominicans will have a much more difficult time competing with Asian suppliers, and demand for U.S. textiles will suffer. Are members of Congress really prepared to reject the CAFTA-DR because it contains some minor exceptions to the rigid rules of origin? If so, the administration should call their bluff.

### **Tough Love**

The administration should announce that it intends to reopen the CAFTA-DR for the express purpose of gutting all of the textile rules of origin. Duty-free clothing access will be granted irrespective of the sources of the textile components. Such a change would be costless—since the textile votes were not there anyway—and would be received enthu-

siastically by U.S. retailers, importers, and our trade partners, who might subsequently be inclined to sweeten the deal for U.S. exporters. Also, the administration should announce it has no intention of expending its capital to convince China to restrain its exports of textiles and clothing.

Beyond the tactic of calling the industry's bluff is the propriety of a strategy that heralds U.S. commitment to trade liberalization. Certainly, by winning reelection by wide margins in textile states, the president has earned the ability to do just that. Voters in textile states could have cast their ballots for the Democratic ticket, both members of which questioned the value of U.S. trade agreements.

Not only did President Bush win all of the major textile producing states, but Jim DeMint won election to the U.S. Senate in South Carolina, running on a decidedly pro-trade message and against an opponent who was heavily funded by the textile lobby. DeMint emphasized the importance of freer trade and globalization to South Carolina, pointing to the state's status as a prominent destination for foreign direct investment, its high rank among all states in terms of the number of workers employed by foreign-owned companies, and the significant export success enjoyed by its manufacturers.

Either South Carolinians were receptive to DeMint's pro-trade message or they do not consider trade to be as important as other issues. Whichever the case, protectionist views may have seen better days—even in textile country. Members of Congress from textile states and President Bush should heed this trend, and follow the example set by now Senator DeMint.

## Conclusion

The administration certainly has developed a troubling habit of protectionist backsliding to win broader support for trade. The steel tariffs imposed in 2002 were widely considered a gesture to win votes from steel-country Republicans for trade promotion authority (TPA). And undoubtedly, the textile caucus remembers how the administration changed certain rules of origin in the Caribbean Basin Trade Partnership Agreement in exchange for its TPA support. But in the present case, a principled commitment to free trade might also be the most promising political strategy for President Bush.

Trade policy is about much more than the textile industry. Accommodating its protectionist desires carries significant real costs for consumers and opportunity costs for other industries. Despite all the exceptions made on its behalf during the Bush administration and in previous years, the industry continues to lobby for special favors. Those efforts should be expected to continue until they no longer prove fruitful.

The Bush administration should move decisively to cut the umbilical cord. The U.S. textile industry has the capacity to walk on its own two feet—and even to thrive. Meanwhile,

such an effort would allow the administration to focus its energies where it should: to promoting international trade policies that benefit the broader U.S. economic interest.

1. The Agreement on Textiles and Clothing was concluded during the Uruguay Round of multilateral trade talks. It directed the elimination of textile and clothing quotas imposed under the Multifibre Arrangement in 1974.
2. Keith Bradsher, "U.S. Official Faults China on Textile Trade Moves," *New York Times*, January 11, 2005.
3. For an in-depth assessment of the CAFTA-DR, see Daniel Griswold and Daniel Ikenson, "The Case for CAFTA: Consolidating Central America's Freedom Revolution," Cato Trade Briefing Paper no. 21, September 21, 2004.
4. For a detailed discussion of this issue, see Dan Ikenson, "Threadbare Excuses: The Textile Industry's Campaign to Preserve Import Restraints," Cato Trade Policy Analysis no. 25, October 15, 2003.
5. Laura Baughman et al., "Of Tyre Cords, Ties and Tents: Window-Dressing in the ATC?" *World Economy* 20, no. 4 (July 1997): 412.
6. Calculated from data provided in Bernard A. Gelb, "Textile and Apparel Trade Issues," Congressional Research Service Report for Congress, RS20436, March 20, 2001, p.2.
7. Edward Gresser, "America's Hidden Tax on the Poor: The Case for Reforming U.S. Tariff Policy," Progressive Policy Institute Policy Report, March 25, 2002, p.4.
8. U.S. Bureau of the Census, IM145 Import Data 2001-2003, www.litr.com.
9. Ibid. Textile products are defined as all products within Section XI ("Textiles and Textile Articles") of the Harmonized Tariff Schedule minus chapters 61 and 62, which cover apparel products and are included in Section XI. The data compared are cumulative totals for January through November 2004 and January through November 2001.
10. Ibid.
11. Van May, comments in "ATNI Blasts Doha Tariff Proposal," ATMI press release, November 26, 2002.
12. Laura M. Baughman, "A Current Assessment of the Health of the U.S. Textile and Apparel Industries: On Life Support or a Case of the Sniffles?" *The Trade Partnership*, October 2004, p.3.
13. Denis Audet, "Structural Adjustment in Textiles and Clothing in the Post-ATC Trading Environment," OECD Trade Policy Working Paper No. 4, August 13, 2003, p.10.
14. For a good discussion of the specific issues raised with respect to rules of origin and other issues of importance to the textile and apparel industries, see Industry Sector Advisory Committee on Textiles and Apparel (ISAC 15), "Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S.-Central America Free Trade Agreement," March 19, 2004.