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Made in China: Is it Over for the U.S. Textile Industry?

by Siyi Guo, Ereny Hadjigeorgalis, and Jay Lillywhite

On January 1, 2005, after more than 40 years of protection, the remaining quotas on textile and clothing imports established under the Multifibre Agreement were removed. The impending liberalization sent a shock through the U.S. and global textile and clothing industries. Fears mounted that China's textile industry would take over world markets and decimate domestic textile industries. International organizations and producer groups predicted that China would account for 50 and 75% of the world trade in textiles and clothing, respectively, and 65 to 75% of the U.S. consumer market. The American Textile Manufacturers Institute predicted U.S. job losses in the range of 650,000, and the National Council of Textile Organizations put the number of global job losses at 30 million.

In response to historical quotas being removed, several countries began erecting barriers to Chinese textile imports. U.S. textile manufacturer organizations filed safeguard petitions with the U.S. Commerce Department in November 2004. Turkey placed emergency import quotas on 43 categories of Chinese textiles to avoid disruption of its thriving textile market. The EU, amid worries that products could flood European markets, also blocked Chinese textile imports.

These fears are not unfounded. The Chinese textile industry benefits from an array of subsidies, direct payments, export tax rebates, and subsidized utilities and shipping costs. In addition, the fixed exchange rate gives Chinese exports a competitive advantage by undervaluing the Yuan and making Chinese exports relatively less expensive than competing exports from other countries. Add to this low labor costs and a perceived abundance of unskilled labor and China's textile industry appears to be a formidable opponent.

But is there another side to this story? Perhaps. To begin with, China's textile industry is broader than the U.S. industry, which generally specializes in spinning. But

more importantly, the Chinese textile industry faces many constraints that could put a drag on any long-term export expansion. Governmental quotas that limit cotton imports, increasing competition for unskilled labor, restrictive re-zoning regulations, electricity shortages, and mounting concerns over pollution could hold off the long-term dominance of Chinese textiles and clothing imports in the United States.

Not Enough Cotton

Cotton is needed to produce textiles and clothing, and China is coming up short in this area. While China's consumption of cotton has been steadily increasing since 1970, production has been volatile (Figure 1). Stocks were completely exhausted in 2003 when consumption outpaced production by almost 2 million tons. This means that China will have to import 1.6 million tons of cotton in 2005 (China Chamber of Commerce for Import and Export of Textiles [CCCT]) to meet current consumption needs. However, cotton imports are controlled by quotas, which for 2005 are set at 894,000 tons. Without government intervention, China faces a shortfall of 706,000 tons of cotton, which could significantly affect the country's textile and clothing production. Any increases in textile manufacturing would have to be matched by either increases in domestic cotton production or increases in import quotas set by the government, both of which are possible but may not be likely given other constraints faced by the country.

Competing for Workers

Contrary to popular belief, China has recently been experiencing labor shortages in key sectors. Labor shortages are spreading rapidly among the belt of manufacturing cities on China's eastern coast – the country's most important

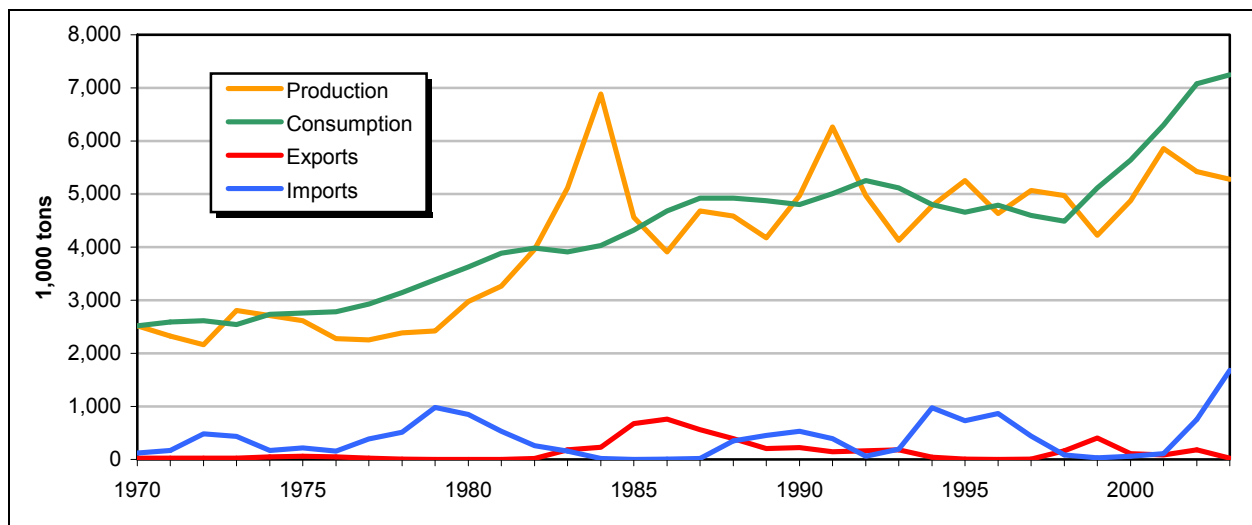


Figure 1. China's production, consumption, exports, and imports of cotton.

industry center (see Figure 2). Most Chinese textile and clothing factories are located in Guangdong, which accounts for nearly a third of China's total exports. This province is experiencing an unprecedented labor shortage of two million workers. Although Guangdong's labor shortage appears to be most acute, it is not unique. Other areas, like neighboring Fujian, report a similar shortage. In fact, the labor shortage has spread widely from Guangdong up through Zhejiang, to the south of Shanghai (*Economist*, Oct. 2004).

A growing service sector and the increasing reluctance of rural residents to seek employment in urban areas have contributed to this critical labor shortage in manufacturing. The service sector, in many cases, offers higher salaries, and the work is less physically demanding than in manufacturing. Rural residents are finding it more attractive to stay on the farm because increased demand for agricultural products has increased incomes and living standards in rural areas. These factors, coupled with a restrictive rural to urban migration policy, have reduced the pool of unskilled labor in urban areas where textile factories are located.

Competition for workers comes not only from the service and agricultural sectors. The textile industry must also compete with other manufacturing industries that have grown rapidly in recent years. Figures released by China's Ministry of Commerce show that foreign and domestic investment, mostly geared towards labor-intensive industries, increased 20% in 2003 over 2002. This investment has spurred a growth in industries such as electronics, telecom equipment, and chemicals that have absorbed a large number of workers that could have alternatively been used by the textile industry.

Running Out of Land

China's economy has been growing rapidly over the last few years, raising concerns of overheating the economy. While an overheated economy is characterized by a high level of economic activity, it also brings with it shooting interest rates and inflation. In China, the steel and cement industries are over-invested, energy consumption is skyrocketing, rice prices are rising, and the volume of real estate loans is growing rapidly. This rapid growth has forced the Chinese government to look into real

estate bubbles and adopt restrictive measures on both real estate loans and land. These concerns and corresponding measures to alleviate possible overheating have made land available for industry expansion more expensive and effectively scarcer in recent years.

Adding to these restrictions is the Chinese government's recent policy agenda to eradicate misuse of farm land to benefit farmers (Ministry of Land and Resource PRC). One of L.L. Bean's major suppliers was forced to delay a big expansion this year when Beijing tightened land-use regulations. TAL Apparel of Hong Kong, a garment-making giant that makes wrinkle-free shirts and pants, had planned to build a second 350,000-square-foot factory near a plant in Dongguan. Beijing then ordered a moratorium on the conversion of farmland for industrial uses, and the project was shelved. (Buckman, 2004).

Who Turned Out the Lights?

China has faced a persistent electricity shortage in recent years. In 2003, severe electricity shortages forced China to impose usage restrictions in 23 regions, affecting about 20 prov-



Figure 2. Map of China.

inces and cities (Denlinger, 2004). In 2004, the Chinese National Electric Watch Committee announced a 20 million kilowatts shortage in the country (Wang & Wang, 2004). The areas most affected in 2004 were primarily the eastern and southern provinces. Eastern China is short 10 to 15 million kilowatts, southern China 5 million kilowatts. In addition, northern and central China are short 3 million kilowatts (Wang & Wang, 2004).

The National Development and Reform Committee reports that in regions with severe electricity shortages, some manufacturing companies are operating on alternate schedules, able to produce only every other day or even every fourth day (Wang & Wang, 2004). Several Japanese companies operating in China reduced production or delayed their product delivery as a result of the modified or shortened operating schedules. One of Panasonic's companies in the

Shunde District of Foshan City in Guangdong province has been without power on Mondays and Tuesdays since February of 2004. Honda's Automobile plant in Guangzhou, the capital of Guangdong province, was asked to close every Friday and Kirin in Zhuhai was asked to close every Wednesday (Lyengar, 2004).

Although China is constructing the new Three Gorges Dam that will provide the country with an additional 18.2 gigawatts of electricity, it will not enter into operation until 2009 at the earliest. The project is also plagued by a myriad of environmental concerns, since inundation of the area with water on the Yangtze River could bring with it dangerous concentrations of toxic waste and pollutants from neighboring industrial centers. For now, and perhaps quite a while, there is no evident solution to China's electricity problem.

It's Not Easy Being Green

Land, air, and water quality in China are deteriorating at a rapid rate. Rampant deforestation for fuel and mining for ore result in desertification. Water demand is growing at a rate of about 10% a year in cities, and about 5% for industry. Sixty million people in the country find it difficult to get enough water for their daily needs (China Growth Cost, 2004). The World Health Organization (WHO) reported in 1998 that of the ten most polluted cities in the world, seven were located in China (EIA, 2003). More recently, the World Bank reported that sixteen of the world's twenty most polluted cities were in China, and it estimated that 300,000 Chinese die each year from respiratory diseases (*Economist*, Aug. 2004).

While pollution has been a growing problem in China for years, there are indications that the government is beginning to take this issue more seriously. In its Ninth National Five-

Year Plan, the Chinese government specifically cited the need to prevent and control pollution in the textile and other highly polluting manufacturing industries. The textile, paper-making, chemical, and food industries have been targeted in particular in the pollution of the Huaihe River, China's third largest watercourse. These industries are responsible for 94% of the ammonia nitrogen discharge in the river and have been blamed for record Chemical Oxygen Demand (COD) levels in the river. In July 2004, the Huaihe Water Resources Committee reported that the river's water quality was at its worst level in history. In December of 2004, *China Daily* reported that only 57.8% of the water in the river was considered safe for domestic, agricultural, or industrial use.

In response to this crisis, the government has gone as far as to call for a restructuring of these industries. Wang Jijie, Vice-Director of China's State Environmental Protection Administration, demanded that local governments restructure the manufacturing sector in accordance with the river's capacity. He urged the enactment of water quality laws and regulations. Kai Ma, Director of the National Development and Reform Commission, stated in a speech to the Fifth China Development Forum that it is vital to restructure industry and to change the current economic growth pattern into a more efficient, environmentally sustainable one. This movement towards a greener China will not be compatible with increased production in these industries in the short term.

Conclusion

Removal of existing trade import quotas has appropriately caused concern for U.S. and global textile indus-

tries. An undervalued Yuan, favorable governmental treatment of the Chinese textile industry, and low labor costs add to this concern. While countries have protectionist measures at their disposal to alleviate such competitive disadvantages with China (e.g., tariff and safeguard measures and antidumping legislation), the need for these measures may not be as necessary long term as once thought. China faces a number of resource constraints that, taken as a whole, may restrain its textile industry from dominating world markets to the degree previously projected.

Rapid economic growth in recent years has thrown China into an era of unprecedented and profound change. The textile and clothing sectors are caught in this web and are constrained in ways that are inherent to a changing Chinese economy. Volatile cotton production and increasing demand for cotton in textile and clothing production, the urgent labor shortage in manufacturing cities, the strained resources of land and electricity, and an alarming environmental deterioration could impede China's textile and clothing industry from future expansion. Whether these constraints will compensate for the advantages that China enjoys in textile production remain to be seen, but these issues must form part of any balanced debate on world textile trade. In the short run, safeguards and trade agreements, such as that recently concluded between China and the E.U., may buy some much needed time for the U.S. textile industry. The future is uncertain, but for now it's not yet over for the U.S. textile industry.

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