# Statement to the Hearing Record
# U.S. Trade Representative
# China's Compliance with WTO Commitments

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**Submission by**
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**NCTO STATEMENT TO THE HEARING RECORD**
**CHINA'S COMPLIANCE WITH WTO COMMITMENTS**

The National Council of Textile Organizations (NCTO) appreciates the opportunity to provide written remarks to the hearing examining China's compliance with its WTO commitments. The issue of China and its adherence to both the spirit and law of its WTO obligations – *and the U.S. government's response* - is central to the profound economic strains the U.S. manufacturing sector has undergone over the last ten years. There is little argument that China's rapid rise to become the world's greatest manufacturing exporter *and* producer has come, in significant part, at the expense of the U.S. manufacturing sector. A recent study estimates that 2.8 million U.S. jobs – or two percent of U.S. employment - have been lost over the last decade due to unfair trade practices by the Chinese government[1]. Most of these job losses have been in manufacturing.

NCTO has been studying the myriad of benefits that the Government of China (GOC) offers to its textile and apparel sector and is pleased to provide the committee with this new comprehensive review of those benefits. While the extent of Chinese subsidization was long suspected, this is the first time NCTO has been able to detail the range of specific programs that the GOC and its provincial authorities offer to its textile and apparel sector. We welcome the opportunity to provide the U.S. government with more specific information on these measures.

In the review, we document 30 different policy initiatives that Chinese central and provincial governments have undertaken to support the Chinese textile sector. As a consequence of these subsidies, NCTO estimates that these subsidies confer a benefit of between 35 and 75 percent for Chinese textile producers.

| **Estimate of Government Benefits for Chinese Textile and Apparel Sector** | | | |
|---|---|---|---|
| | Type | Description | Size |
| 1. | Subsidies and Grants | A wide range of industrial and textile specific measures covering financing, land use, technology upgrades, fiber use, taxes etc. | 5 to 30 percent |
| 2. | Increased VAT Export Tax Rebate | Increased from 11 percent to 16 percent | 5 percent |
| 3. | Currency Manipulation | Sourced from a wide range of estimates. | 25 to 40 percent |
| | **TOTAL** | | **35 to 75 percent** |

In terms of specific subsidies that we are reviewing in the context of China's WTO compliance, we estimate using standard countervailing duty methodologies that Chinese textile and apparel companies derive a benefit of between 5 and 30 percent *ad valorem* from Chinese government subsidies. The most significant subsidies are being offered in terms of preferential lending, preferential land use rights and reduced costs for cotton and man-made fibers. Smaller but still significant subsidies include income tax reductions, indirect tax programs, discounted electricity and grant programs.

It is important to note that the estimates for these policy initiatives, that provide benefits to Chinese textile mills, do not include the use of export tax rebates and currency manipulation by the GOC. Because the government does not recognize those as WTO issues, these two issues are reviewed in a

[1] Economic Policy Institute Briefing Paper, Growing U.S. trade deficit with China cost 2.8 million jobs between 2001 and 2010 by Robert E. Scott. September 20, 2011. Link to EPI Paper

second section. These two subsidies are clearly larger than any one of other 28 policy initiatives and add another 25 to 45 percent benefit to NCTO's estimates.

While outside the scope of this particularly hearing, as NCTO notes in its conclusion, the U.S. government needs to confront the reality that its response to China (vis-à-vis China's industrial policies) has largely failed. As China continues to provide massive support to its export industry and those exports will continue to drain the U.S. economy of badly needed jobs, wealth, and tax revenue. To date, U.S. manufacturing has shown no sign that it can become the powerful driver that the U.S. economy needs while it is being forced to compete with the Chinese government on a sustained unequal playing field. Unfortunately, the U.S. government (and Congress) continues, to a significant extent, to be unwilling to confront this essential fact.

In regard to textiles, the cumulative impact of these subsidies outlined in our review is undoubtedly the major driver in the domination of the U.S. market by the Chinese textile and apparel sector. Textile and apparel trade is intensely competitive, often operating at profit margins of three to five percent. As a result of the Chinese subsidies, it is clear that U.S. textile companies and our trading partners throughout the Western Hemisphere have lost billions of dollars in production and exports, as well as hundreds of thousands of jobs.

Background on Trade and U.S. Textile Industry

The U.S. textile industry is the third largest exporter of textiles in the world. As of July 2011, the textile industry in the United States employed 239,600 workers. The industry continues to invest heavily in new technologies, processes, and research and development to maintain a cutting edge in the global economy. Capital spending in the textile sector has averaged more than $1 billion annually for the last decade. Many sectors of the industry have expanded employment this year, even as the national unemployment rate has remained at historically high levels. Further, according to U.S. government statistics, the overall U.S. textile sector supports more than one million U.S. jobs indirectly.

The U.S. textile industry is one of the most export dependent sectors in the U.S. manufacturing spectrum with more than $15 billion in exports in 2010. The U.S. industry's survival and growth depends on strong export markets and fair and unfettered access to world markets. Nearly two-thirds of these exports go to our Free Trade Agreement (FTA) partner countries in the Western Hemisphere.

Unfortunately, textiles have long been singled out by China for special government benefits and support. Each of the past eleven Five Year Plans by the Chinese government have include specific Five Year Plans for Textiles. In addition, at least seven Chinese provinces (Fujian, Guangdong, Henan, Jiangsu, Jiangxi, Shandong and Zhejiang) produce their own Five Year Plans that target textiles with special provincial and municipal benefits.

The trade data concerning China and textiles is revealing. As measured in square meter equivalents (SMEs), China's market share of U.S. apparel imports has risen from 5.8 percent in 2000 to 41 percent for year-ending July 2011. In the textile sector, the growth has been just as dramatic with China increasing from 14 to 51 percent of the U.S. import market during the same time period.

This enormous growth has taken place since China joined the WTO and quotas were phased out on its textile and apparel exports. In return for the quota phase-out, the U.S. textile industry was assured that

WTO membership would force China to embrace free market principles, stop supporting its state-owned textile sector, only offer loans and financial support from its banks based on commercial standards, reduce and eventually eliminate subsidies to its industrial sectors and halt the manipulation of its currency, among others.

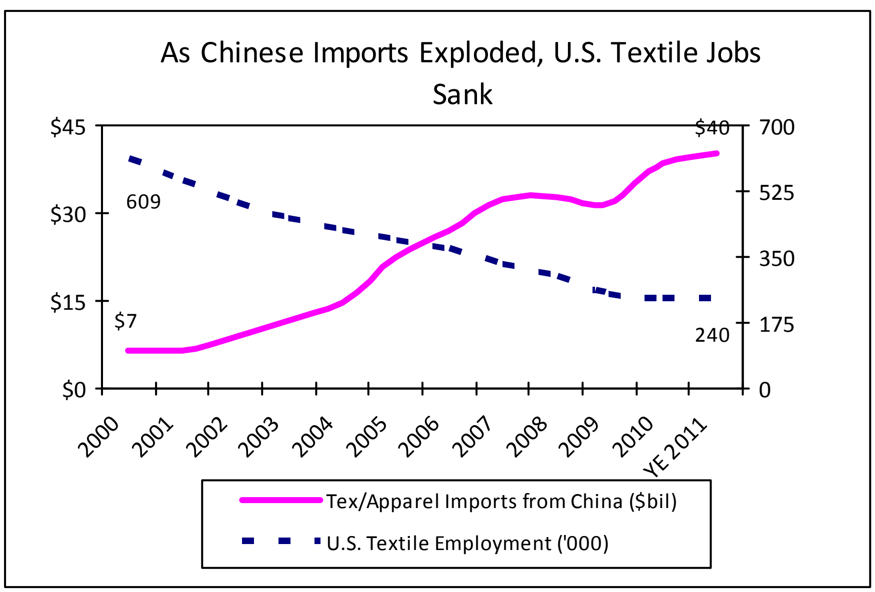
To date, none of these actions have happened. Instead, China has boosted support for its textile sector, increased the subsidization of the yuan to almost incomprehensible levels (now averaging almost one billion dollars a day), privatized its state-owned companies on decidedly non-commercial terms, introduced many new measures to get around WTO rules and has regularly rescued major portions of its textile sector through loan extensions and/or debt wipeouts.

As you see with other U.S. manufacturing sectors, our trade statistics continue to demonstrate that China's growth has come at the expense of U.S. textile production and regional apparel production. Apparel imports from the Western Hemisphere (including NAFTA, CAFTA, CBI, and Andean) accounted for 41percent of the U.S. import market in 2000. As of July 2011, U.S. apparel imports from the Western Hemisphere have been reduced to just 19 percent of the U.S. market.

In dollar terms, the Chinese growth has been even more stunning. Since its entry into the WTO, China has increased its textile and apparel exports to the United States by 489 percent or by $32 billion. With $39 billion in exports to the U.S. in textiles and apparel, China today is six times larger than its next largest competitor - Vietnam. In 2000, China ranked second among textile and apparel suppliers to the U.S. market, two-thirds the size of the largest supplier, Mexico. In 2010, Mexico was the fifth largest supplier with textile and apparel exports to the U.S. totaling $4.4 billion, down 54% since 2000.

U.S. textile job losses, not surprisingly, have been severe. From China's entry into the WTO to today, the U.S. textile industry has lost 379,000 workers - 63 percent of its workforce - and more than one thousand textile mills have closed across the country. These closures have devastated many rural communities in the U.S. with dozens of towns and localities essentially bankrupted as their major employers have been eliminated.

The indirect impact has been even greater, as U.S. government statistics show that every textile job supports three other jobs. Traveling through a textile community one sees this immediately: machinery, transportation, chemical, waste, and fiber jobs are all gone. In addition, many retail and government (school, fire, police etc) jobs have declined, showing the direct result of lost state and local revenue to the communities.



Chinese Subsidy and Support Programs for Textiles: WTO Review

The following is a review of Chinese programs that provide support for the Chinese textile sector. These programs are broken into five major categories: 1) Income Tax Programs, 2) Indirect Tax Programs, 3) Preferential Lending/Debt Forgiveness, 4) Government Provision of Goods and Services, and 5) Grant Programs.

As noted earlier, two very significant areas – the Chinese export tax rebate and Chinese currency manipulation – are reviewed in a separate section.

**Please note: Subsidies that NCTO believes are WTO Prohibited are bolded and include #5, #7, #14, #27 and #28.**

Income Tax Programs

NCTO has identified 11 types of subsidies related to income taxes. All of these are actionable subsidies because they target a specified group and grant specific benefits that cause adverse effects on global trade, including the U.S. textile industry and our trading partners in the Western Hemisphere.

1. Tax Exemptions and Reductions for "Productive" Foreign Invested Enterprises (FIE).
    - For example, under the Two Free, Three Half program (which has been replaced officially, but is still in operation for some companies) and similar programs, companies with at least 25 percent foreign capital may receive an exemption from income taxes during their first two years of profitability and pay income taxes at only half the standard rate during the next three years.

2. Provincial Income Tax Exemptions and Reductions for FIEs
    - A provincial program modeled after #1, these benefits were technically eliminated in 2008 but textile and apparel companies may continue to receive tax breaks from provincial authorities.

3. Tax Refunds for Reinvestment of FIEs.
    - When profits are used to establish another FIE scheduled to operate at least five years, companies are eligible for a refund of forty percent of the corporate income tax already paid on the invested amount if the recipient is an export-oriented or advanced technology enterprise.

4. Tax Reductions for FIEs in Designated Geographic Locations
    - Textile and apparel companies operating within a certain development or economic zone receive reduced income tax rates of 15 or 24 percent. While this program has been technically "ended," the information available indicates textile and apparel companies continue to receive benefits.

5. **Tax reductions for Export-Oriented FIEs**
    - **Tax reductions are available after expiration of the Two Free, Three Half program if exports account for 70 percent of a company's sales. These benefits are in addition to**

**others available to the reductions available for locating in specified geographic locations. This is believed to be a prohibited subsidy because it relies on export performance**

6. Tax offsets for Research and Development at FIEs
   - Research and development expenses at FIEs may be offset by up to a 50 percent reduction in taxable income.

7. **Tax reductions for FIEs and other Foreign Enterprises Purchasing Chinese-made Equipment**
   - **This is believed to be a prohibited subsidy because it is contingent upon the purchase of domestically produced goods over imported goods.**

8. Tax reductions for High and New Technology Enterprises (HNTEs)
   - "Key industries", which includes the textile industry, get a reduced tax rate of 15 percent if they meet certain technological criteria, which are often vague.

9. Tax reductions for FIEs that are also HNTEs and are Located in Development Zones
   - Another "expired" program whose benefits continue for Chinese textile companies. Tax rate is reduced to 15 percent, along with additional tax benefits that are awarded by the individual zone.

10. Tax reductions for HNTEs Located in Economic Zones
    - Companies falling under this category, which include many textile companies, get exempt from income tax for two years and then pay only half the normal tax for the next three years.

11. Tax reductions for Enterprises Located in Special Economic Zones
    - Another "expired" program accessed by the Chinese textile industry whose benefits continue.

12. Tax reductions and exemptions for Enterprises Invested in Western Regions
    - These regions are targeted for textile development. This is another "expired" program whose benefits continue.

Indirect Tax Programs

NCTO has identified two types of subsidies related to indirect tax programs. Although Value Added Tax (VAT) taxes are allowed under WTO rules, discriminatory use of VAT taxes to develop "encouraged[2]" industries has an adverse effect on companies competing in the global market.

13. Value Added Tax (VAT) and Tariff Exemptions on Imported Equipment
    - Used by encouraged industries to get access to advanced textile and apparel machinery.

14. **VAT rebates on FIE purchases of domestically-produced equipment**

[2] The textile industry is among a list of industrial sectors that the Chinese government "encourages" by developing preferential policies and programs.

- **Available to the textile industry and identified as a prohibited subsidy because the rebate is contingent on the purchase of domestically made goods over imported goods.**

Preferential Lending/Debt Forgiveness

15. Preferential Lending, Debt Write-off & Other Preferential Programs by Chinese "Policy" and "Commercial" Banks
    - The Chinese government continues to direct both its "policy" banks (Agricultural Development Bank, the China Development Bank and the Export-Import Bank of China) and its "commercial" banks (the Agricultural Bank of China, the Bank of China, the China Construction Bank and the Industrial Bank of China) to follow national economic and social development goals and the industrial policies of the State when extending credit. The GOC in recent pronouncements specifically directs Chinese financial institutions to "increase credit," extend loan terms and write off debt for the textile industry.

16. Preferential Lending, Debt Write-off & Other Preferential Programs at Regional and Municipal Banks
    - Provincial governments in at least Fujian, Henan, Zhejiang, Jiangsu and Xinjiang -- as well as municipal development banks -- have followed the central government's lead by specifying special rates, credit extensions and debt write-offs for local textile companies.

Government Provision of Goods and Services

17. Discriminatory Land Policies by the Government of China
    - The Government of China owns all land in the country and distributes rights and access to that land based on national industrial policies. In particular, the government charges significantly less for land in special access zones which are available to encouraged industries, including textile companies. In addition, state-owned enterprises pay only nominal fees for their "allocated" land use rights.

18. Discriminatory Land Policies by the Government of China
    - Regional and municipal governments follow the GOC's directives regarding access to land and offer textile companies discounted access to land in terms of reduced rates and land use fees.

19. Discounted Electricity Rates by Provincial Authorities for Textile Producers
    - As part of incentive packages for textile companies, many Chinese provinces and municipalities provide electricity at a discount. Electricity is one of the largest costs for any textile company, so such discounts have a significant impact when such firms compete in global markets with firms that pay market prices for utilities.

20. Programs to Ensure Access to Lower Cost Cotton
    - The GOC provides numerous programs that help ensure that Chinese textile companies pay lower costs for cotton than global competitors. These include import quotas, a strategic cotton reserve which is used as a commercial instrument, state trading

restrictions, exemptions from agricultural income taxes, low cost loans to cotton producers and subsidies for shipping costs.

21. Programs to Ensure Access to Lower Cost Man-made Fibers
    - The GOC controls the petrochemical sector and requires petrochemical companies to sell refined petrochemical products, including polyester and other man-made fibers used in the production of textile yarns, at below cost. The GOC compensates these companies by providing large annual subsidies to cover their operating costs.

Grant Programs

The Government of China and provincial governments provide a variety of grants to promote textile industry development. Some of these grants are highly questionable, particularly if they are predicated on exports. NCTO has identified seven types of grant programs provided to the textile sector.

22. Special Textile Funds Authorized under the "Administration of Textile Special Funds" Program and the "Circular on Relevant Policies to Promote Chinese Textile Industry to Shift to New Ways for Growth in Foreign Trade and Support Chinese Textile Enterprises to 'Go Global'*." According to reports, the funds available amounted to 1.36 billion RMB ($217 million)*.

23. State Key Technology Renovation Project Fund
    - Covers up to two years of interest payments for machinery for textile and other enterprises, especially if located in the northeast, central or western areas of China.

24. State Science and Technology Support Scheme
    - Grants for technology "renovation" for textiles and other encouraged industries.

25. "Famous Brands" awards
    - Grants for creating "Chinese Brands," this program was "officially" halted in 2010 but the Chinese government continues to make payments.

26. Clean Production Technology Fund
    - Monetary rewards for textile and other companies that pass environmental inspections.

27. **Export Interest Subsidy Program**
    - **For textile and other exporters operating in at least Shenzhen and Zhejiang Provinces, the Chinese government provides a three percent interest subsidy for exported goods. This program is believed to be a prohibited subsidy because it is contingent on export performance**.

28. **Funds for "Outward Expansion" of industries in Certain Provinces**
    - **These funds, which are available in the Jiangsu, Zhejiang, Shangdong and Guangdong provinces, allows eligible enterprises, including textile companies, to apply for special funding to assist in the development of export activities. This program is believed to be a prohibited subsidy because it is contingent on export performance.**

Other Programs: Export Tax Rebates & Currency Manipulation – Non WTO

29. Export Tax Rebates
    - The GOC has historically manipulated its export tax rebates in order to boost specific sectors. The most recent example of this occurred during the financial crisis when China boosted its export tax rebates for textile and apparel from 11 percent to 16 percent in 2007/8. The Chinese government took this action after pledging at the G-8 that it would take no market distorting actions that impact world trade. The impact, however, was quick – while Chinese exports had begun to decline, the additional five percent subsidy allowed Chinese exports to undercut their competitors and gain large amounts of the U.S. market share. China later justified the increase based on worldwide financial conditions. Despite the return for financial stability, the GOC still has not reduced the export tax rebate to previous levels. Many textile analysts feel that the export tax rebate is the single biggest textile-specific subsidy granted to the Chinese textile industry. *NCTO estimates that the increased rebate amounts to an annual subsidy of more than $10 billion*.

30. Chinese Currency Manipulation

    - NCTO continues to urge the U.S. government to declare China a currency manipulator and to allow currency manipulation to be a countervailable subsidy. Estimates of the size of the subsidy range from 20 to 40 percent. Suffice it to say, that even a much smaller subsidy – just five percent - has a dramatic impact, as the export tax rebate increase in 2007 demonstrated. In addition, textiles are one of the most vulnerable sectors to currency manipulation because China is strongly vertical in textile production and sources fibers, yarns, fabrics and then producers the final garment largely from Chinese manufacturers. Thus, the currency provides a distinct benefit for each manufacturing step in the supply chain.

      Absent strong action by the U.S. government, China will continue to use its currency as an economic weapon, one that is primarily aimed at the U.S. manufacturing sector and U.S. workforce. We continue to be disappointed that the U.S. government's approach has yielded few results, except perhaps to convince the Chinese government that the U.S. lacks the resolve necessary to defend its vital economic interests. In terms of a single action the U.S. could take in order to benefit domestic manufacturing jobs and the domestic manufacturing base would be to directly and effectively have China rebalance its currency.

<u>The Cumulative Effect of the Chinese Government Support</u>

NCTO has analyzed the WTO relevant subsidies provided to producers of textiles and apparel from each of these major categories of actionable and prohibited subsidies, but not including the impact of China's export tax rebate and currency manipulation. As noted earlier, and depending on the individual company circumstances, estimates of the benefit of the 28 reviewed subsidies range from 5 to 30 percent *ad valorem*. In addition to those subsidies, China hiked export tax rebates on textile products by five percent and, on the currency side, most economists believe the yuan is overvalued by between 25 and 40 percent. Total subsidization benefits to Chinese textile and apparel exporters range from 35 to 75 percent.  It is no wonder that in the past ten years, the Chinese textile industry has grown to overwhelmingly dominate world trade in textiles and apparel.

In looking at the WTO relevant subsidies, we can provide more specific estimates based on type of subsides.  After a review of company financial records and other publicly available information, NCTO estimates that the subsidy rate for the various income tax programs benefiting textile and apparel producers would be up to three percent *ad valorem* for many companies.  The subsidy rate for the various indirect tax programs would be up to one percent *ad valorem* for most companies.  The benefit of preferential lending and debt forgiveness programs could be up to five percent *ad valorem*, but that amount will vary based on the amount of money borrowed.  The value of goods and services provided by the Government of China for less than adequate remuneration also varies by company, with the rate for land use rights for many companies up to five percent *ad valorem*, for electricity less than one percent *ad valorem*, manipulation of Chinese prices for cotton provide a subsidy rate of up to eight percent ad valorem, for polyester fiber up to six percent *ad valorem*.   The benefit of GOC government grants is up to two percent *ad valorem*.

## Conclusion

When added to China's perennially undervalued currency and export tax rebates, it is clear that Chinese government support has been the primary driver for China's huge export surge in textiles to the U.S. market over the past ten years.  It's also clear that while some of these programs are clearly WTO inconsistent, many others violate the promises that China made during its WTO accession to disengage its government support programs and operate its industry on free market principles.

Ten years after China joined the WTO those promises appear to be ever more distant as China has quickly replaced clearly WTO inconsistent programs with new programs that provide the same or larger levels of government support to its manufacturing sector.  As prior USTR reports have noted, China has also come up with new government initiatives which seek to ensure that Chinese companies are ascendant in the worldwide manufacturing sector.

To date, the U.S. government response has been unable to seriously impede the Chinese government's support for its manufacturing sector and the WTO agreements have proven to be an inadequate safeguard to ensuring equitable trade.  This combined failure has had significant impact on U.S. employment, wealth and national security.   With tens of millions of American workers unemployed, the U.S. manufacturing sector stagnant and the U.S. standard of living in a long term decline, we believe that the U.S. government needs to reassess its fundamental approach to China and the impact that the Chinese government's continuing and apparently indefinite support for its manufacturing sector has had - and will continue to have - on the United States and its workers.

Thank you for providing us the opportunity to discuss this important issue.

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## Key Facts about the U.S. Textile Industry

- The U.S. textile sector is one of the largest manufacturing employers in the United States. In 2010, the overall textile sector, from fibers to final garments and other textile products, employed nearly 600,000 workers. Textile companies alone employed 255,000 workers.

- The U.S. textile sector is the third largest exporter of textile and apparel products in the world with exports growing 19 percent in 2010 to more than $20 billion. U.S. textile exports totaled more than $15 billion.

- U.S. textile exports support a textile and apparel platform created by the NAFTA/CAFTA/Andean free trade areas that now employs nearly two million workers.

- The U.S. textile industry supplies more than 8,000 different textile products each year to the U.S. military.

- The U.S. textile industry has a long history of creating innovative, hi-tech products, from heart valve prosthesis and nanotube body armor to non-iron apparel and moisture wicking athletic wear.

- The U.S. textile industry invested more than $15 billion in new plants and equipment from 2001 to 2009. U.S. textile shipments totaled $51 billion in 2010.

- The U.S. textile industry increased productivity by 45 percent over the last 10 years, making textiles one of the top industries among all industrial sectors in productivity increases.

- In 2010, textile workers on average earned 155% more than clothing store workers ($559 per week vs. $219) and received health care and pension benefits.