

## **4 China Denim Apparel Industry**

### **4.1 PRODUCTION**

The Chinese denim apparel industry consists of more than 400 manufacturers and has a huge production capacity, as shown in Figure 4.1. The industry had the capacity to produce 164 million units per year in 1995, and 172 million units in 1996. However, the capacity fell by 8.7 per cent to 157 million units in 1997. The actual production of Chinese denim apparel was 115 million, 116 million and 101 million units in 1995, 1996 and 1997 respectively. Production fell by 12.9 per cent in 1997, and there were more than 48 million units of overcapacity in 1995, growing to 56 million units in 1996. This over-capacity didn't reduce until 1997. The over-capacity wasted a large amount of investment in China's denim apparel industry and brought considerable pressure on denim apparel producers. (See Fig. 4.1)

### **4.2 MARKETS**

The total sales volume of denim garments in China fell between 1995 and 1997 as shown in Figure 4.2. In 1995, 110 million units of denim garments were sold in China, rising to 116 million units in 1996. However, in 1997 the sales fell to less than 100 million units. The reason for the decline was the sharp fall in exports markets. China exported 65.3 million units of denim apparel in 1995 but only 35.2 million units in 1997. (See Fig. 4.2)

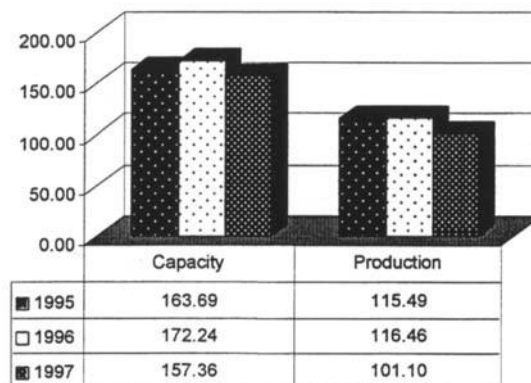
The established industry is export-oriented, and over 80 per cent of Chinese denim apparel was exported to overseas markets. However, exports have declined in recent years. China exported 65.3 million units of denim apparel in 1995. From 1996, the situation in which overseas markets played a dominant role for China's denim apparel industry has changed. In 1996, with a reduction of 17.7 per cent in 1996, its denim apparel exports reduced to 54 million units. This was the first time that domestic consumption exceeded the export volume. Furthermore, with a reduction of 34.5 per cent in 1997, China exported only 35.21 million units of denim apparel. Compared

with the export volume in 1995, the decrease was significant. On the other hand the domestic consumption increased from 45.04 million units in 1995 to 63.8 million units in 1997, and became the most important market to the China denim apparel industry. (See Fig. 4.2)

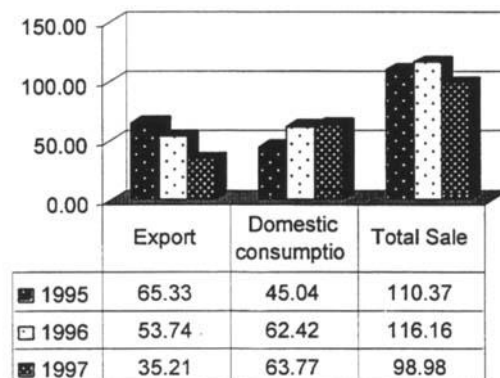
#### 4.2.1 US market

The US denim market is the largest in the world. The NPD Group, a Port Washington, N.Y., consumer research group, reported that 544.3 million pairs of denim jeans were sold in the US in 1996 [1]. Apart from denim jackets, skirts, and other denim products, over 1.5 million pairs of denim jeans were sold daily. Denim jeans were beloved by everyone, from blue collar to white collar; and from miners to the President of the United States. Having broken through all class and age barriers, thus ultimately became the uniform of America and symbols of the American lifestyle.

The US denim jeans market was dominated by a few leading producers. At the beginning of the 1990s, Levi Strauss shared 31 per cent of the USA jeans market, VF (Lee, Wrangler) contributed 17.9 per cent, Licensed/Designer had 6.0 per cent, Private label took 3.2 per cent, and Gap Inc. had 2.7 per cent. At the end of 1990s, the



4.1 China denim apparel capacity and production (million units)



4.2 China denim apparel total sales (million units)

US denim jeans market concentrated in leading companies more and more. More than 74.3 per cent of the USA denim jeans sales were from leading companies (Levi's contributed 16.9 per cent, VF (Lee, Wrangler) 25.3 per cent, Licensed/Designer 7.0 per cent, Private label 20.2 per cent, Gap Inc. 4.9 per cent) and others shared the remaining 25.7 per cent. (Source: Tactical Retail Monitor) [Carol Emert, 02/23/1999 #184]. Foreign made denim apparel has a very small part to play in the USA market.

To define the position of Chinese denim apparel in the USA market, the US import market was surveyed.

#### *Introduction to the USA denim apparel import market*

Besides absorbing its huge domestic production, the USA also imports a lot of denim apparel from overseas. Denim apparel imports played a dominant role in USA total denim product imports, which accounted for about 83 per cent of US total denim product imports (see table 1). The denim apparel import value has increased in recent years. It was US\$ 1.3 billion in 1995, US\$ 1.5 billion in 1996 and became US\$ 1.7 billion in 1997. The increasing import trend continued in the first eleven months of 1998 so that more than US\$ 2.0 billion worth denim apparel was then imported to the USA.

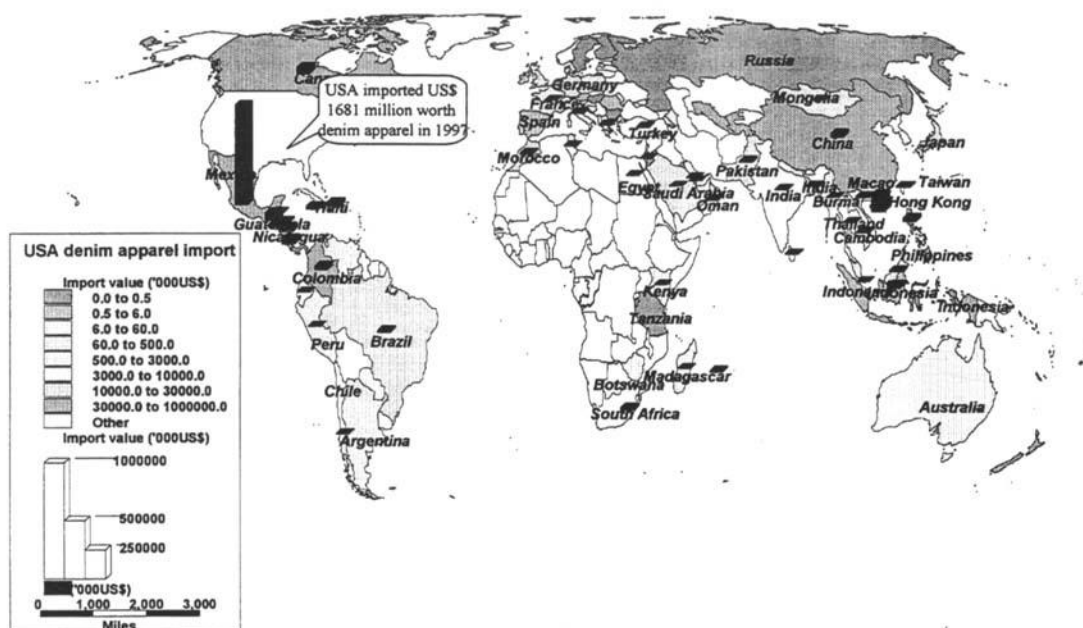
The most important denim apparel supplier was Mexico, which shared more than one half of USA imported denim apparel. Benefiting from a member of NAFTA (North American Free Trade Agreement), Mexico played a more and more important role in the US import market. Following Mexico, other suppliers were Hong Kong, Guatemala, Canada, Costa Rica, Dominican Republic, Nicaragua, Colombia, China, Philippines, and Indonesia. Except Hong Kong, China, Philippines, and Indonesia, many important denim apparel suppliers are American countries. (See Fig. 4.5 and 4.6)

The average price of the US imported denim apparel was around US\$ 7.2~7.5 per unit. The USA imported high price denim apparel from Italy, France, Belgium, and Japan. The denim apparel from Macao was around US\$ 9~11 per unit, and was US\$ 12 to 15 per unit for from Canada. The low price denim apparel was mainly from the South American countries and the developing Asian countries. (See Fig. 4.3 and 4.4)

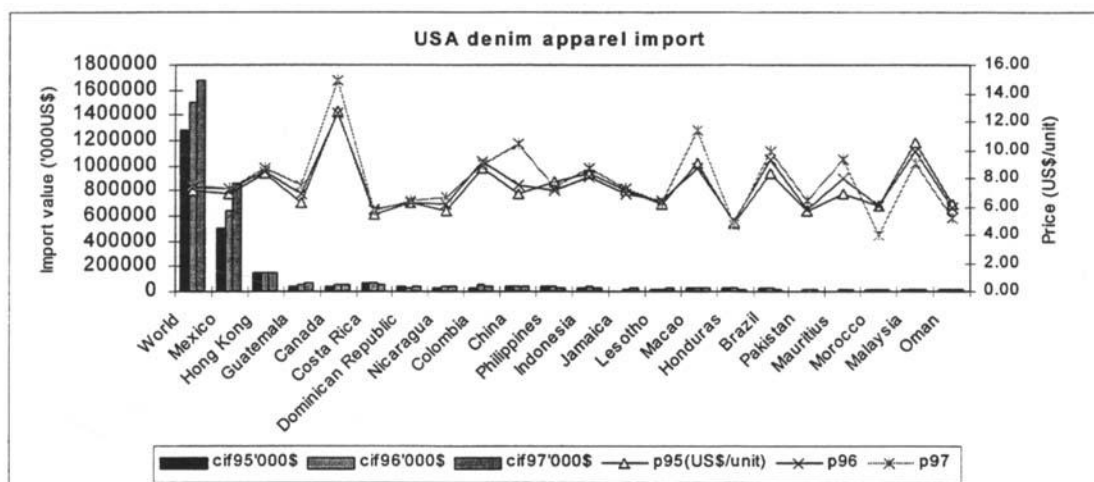
#### *Chinese denim apparel in the USA market*

China exported US\$ 38, 44, and 37 million worth of denim apparel to USA in 1995, 96 and 97 respectively, which amounted to 3.0, 2.9, and 2.2 per cent of US denim apparel imports in each year. China was the 9th largest supplier to the USA denim apparel import market in 1997, declining from being the 7th exporter in 1995 and 1996. The export value of Chinese goods reduced sharply in 1997. However, in the first eleven months of 1998, the export value increased to US \$52 million, and grew 44 per cent compared with the same period in 1997.

After Mexico, Hong Kong, Guatemala, Colombia, Canada, Nicaragua, and Costa Rica, China was the 8th largest men's or boy's denim apparel exporter to the US market in 1997. China exported US\$ 21, 21 and 26 million (C.I.F) or 2.75, 2.42 and 2.38 million units of men's or boy's denim apparel to the USA in 1995, 1996 and 1997 respectively, showing that China's men's or boy's denim apparel export volume decreased but the value increased.



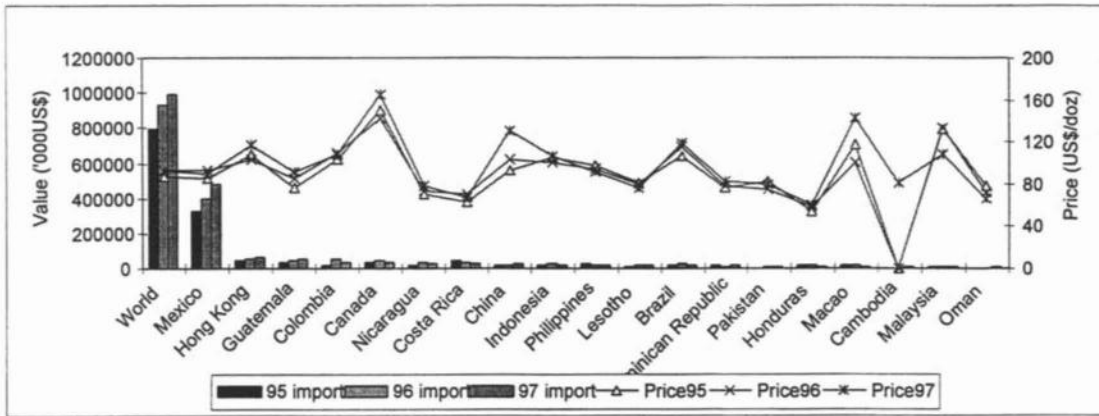
4.3 USA denim apparel imports



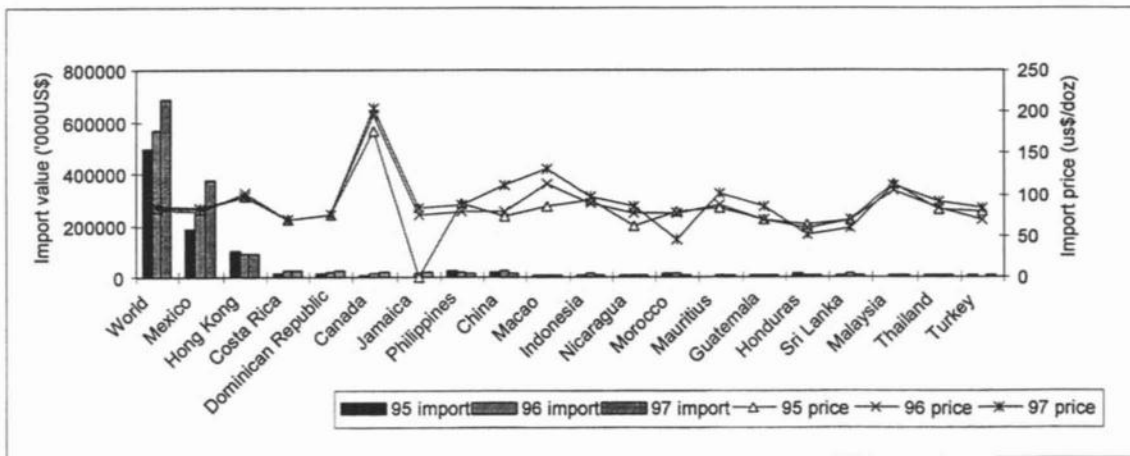
4.4 USA denim apparel imports by value and price

Between 1995 and 1997, the price of men's or boy's denim apparel exported from China increased in the USA market. The average export price was increased from 7.78 US\$ per unit in 1995 to 10.9 US\$ per unit in 1997, an average growth rate of 13.4 per cent every year. (See Fig. 4.5)

China also was the 8th exporter of women's or girl's denim apparel in the USA market in 1997, behind Mexico, Hong Kong, Costa Rica, Dominican Republic, Canada, Jamaica and Philippines. China exported US\$ 17, 23 and 11 million (C.I.F.) worth of women's or girl's denim apparel to the USA market, accounting for 3.4, 4.1 and 1.5 per cent of US total female's denim apparel import in 1995, 1996 and 1997 respectively, and amounting to 2.7, 3.5 and 1.1 million units in volume. The export of women's or girl's denim apparel fell sharply in 1997 in terms of both value and volume. The price of Chinese exported women's or girl's denim apparel increased from US\$ 6.1 per unit in 1995 to US\$ 9.3 per unit in 1997. (See Fig. 4.6)



4.5 Men's or boy's denim apparel imports into USA



4.6 Women's or girl's denim apparel imports into USA

From 1997, the price of female's denim apparel from China (US\$ 9.28 per unit) was higher than the average price of US imports (US\$ 7.12 per unit). The price of male's denim apparel was higher than the USA average import price from 1996, the relevant prices being US\$ 8.66 per unit from China and US \$7.8 for the import average. The price of male's denim apparel continued to increase in 1997, when it was US\$ 10.9 per unit. Among the USA's ten largest denim apparel suppliers, China was the second highest priced supplier after Canada. Other high price denim apparel suppliers, such as Italy, France, German, etc. have a very small market share in the USA import market. In contrary with the EU market, the data indicated that China has changed from being low-value added denim products supplier to a middle-high value added denim apparel supplier in the USA market. (See Fig. 4.6)

#### 4.2.2 The EU market

Europe is an important denim apparel market with its own features. The denim market in Europe is traditionally fashion-oriented, and not basic as in the US. Many famous brand denim apparel were designed and manufactured in Europe, with names such as Versace, Armani Jeans, Diesel, Esprit jeans, Gaultier, Moschino Jeans, Replay etc

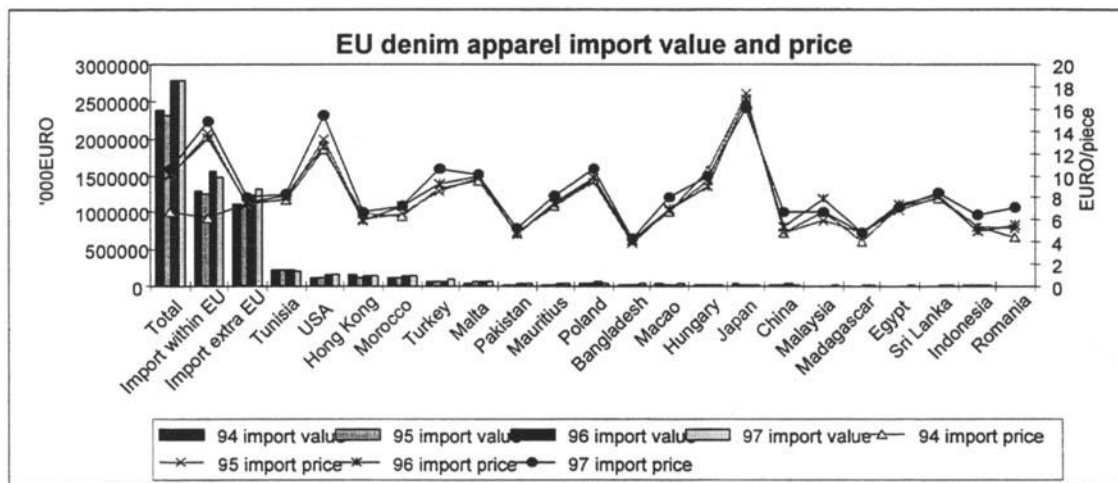
prominent. European top fashion designers introduced their denim apparel in the house show every season. The European demand for denim has been vastly diversified, and there are many different fabric styles with short life cycles. The European market was regarded as high class with trendy innovation. The local manufacturers applied quick response and just-in-time as competing tools, availability being more important than cost in the European market [2].

*Introduction to the EU denim apparel import market*

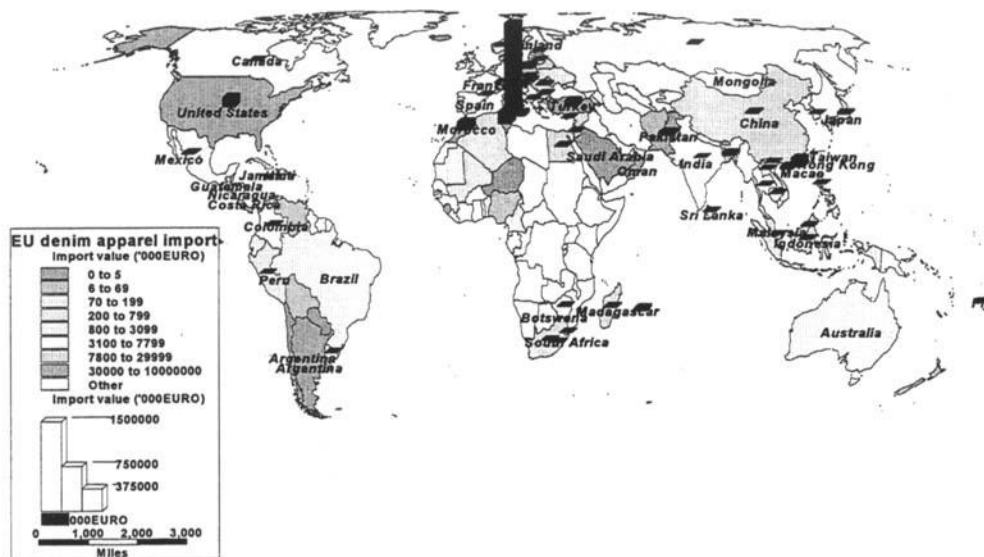
EU is an important denim apparel import market. EU members imported 2.9, 2.8, 2.8, and 3.2 billion Euro worth of denim products in 1994, 95, 96 and 97 respectively. Among these, most are denim apparel and little denim fabric was imported. There were 2.4, 2.3, 2.8 and 2.8 billion Euro worth of denim apparel imported to EU members in 1994, 95, 96 and 97. EU countries importing denim apparel get them within the EU: more than half of the imports were from EU members. The USA, Hong Kong, Morocco, Netherlands, and Turkey were the four most important non-EU member exporters to the EU. (See Fig. 4.3)

EU countries imported 1.1, 1.1, 1.2 and 1.3 billion Euro of denim apparel from non-EU countries in 1994, 1995, 1996 and 1997 respectively. The top three denim apparel suppliers (non-EU countries) were Tunisia, USA, and Hong Kong. (See Fig. 4.7 and 4.8)

The average price of denim apparel imported to EU countries was around 10 Euro per piece. The average price of denim apparel imports from within the EU was above 13 Euro per piece, higher than the price of apparel imported from non-EU countries at about 8 Euro per piece on average. Among the non-EU countries, Japanese denim apparel exports were at the highest price (above 16 Euro per piece), followed by the US with a price between 12-15 Euro per piece. (See Fig. 4.7)



4.7 EU denim apparel imports



4.8 EU denim apparel imports

### *Chinese denim apparel in the EU market*

China exported 26.3, 17.7, 31.1 and 17.8 million Euro worth of denim apparel to the EU in the years 1994 to 1997. China was the 25th largest exporter of denim apparel among all countries in 1997, and the 14th exporter among non-EU countries. The China denim apparel sector seems weak in the EU market compared with China's other textile sectors.

China's denim apparel was exported to EU at an average price of 6.67 Euro per piece in 1997. Though it increased from 4.9 Euro in 1995 and 5.34 Euro in 1996, the price was much lower than the EU average import price, and also lower than the average price from non-EU members. The price was similarly to those of Pakistan and Bangladesh. In the EU market, China denim apparel were thus in low value added products even though that the price has increased in the past few years.

The effect of the establishment of the European Union and the North American Free Trade Agreement, on denim trading in the most two important markets in the world –the US and the EU has been the rise of regional concentration. Trading between the EU/NAFTA members and their surrounding countries grew, while it decreased with other countries. This threatens the trade between China and the EU/US. In both markets, the share of China's denim apparel has declined in the past few years.

In foreign markets, China's denim apparel industry was facing not only trade barriers, such as trading regional concentration, quotas and tariffs, but also stiff competition from other developing countries. In the EU market, its neighboring countries Tunisia, Turkey, Morocco, and Poland, become major competitors of China. These countries have low labor costs compared with the EU countries, and their closeness tends to mean that they have similar cultural background. Many EU producers shifted their manufacturing factories to these countries, which became new denim apparel producing bases outside the EU. In the same way, US producers moved their manufacturing processing to the South American countries to reduce the labor costs, and also provided favored tariff rates to denim products made in these countries. In the long term, low labor costs are the most important competition advantage in the world market. China was facing more and more stiff competition

from the low labor costs countries, and had to change its competitive strategy from low cost dependent to higher value-added. In the years under consideration, the average price of the product from China had been increased. This testifies the progress the Chinese denim industry has made.

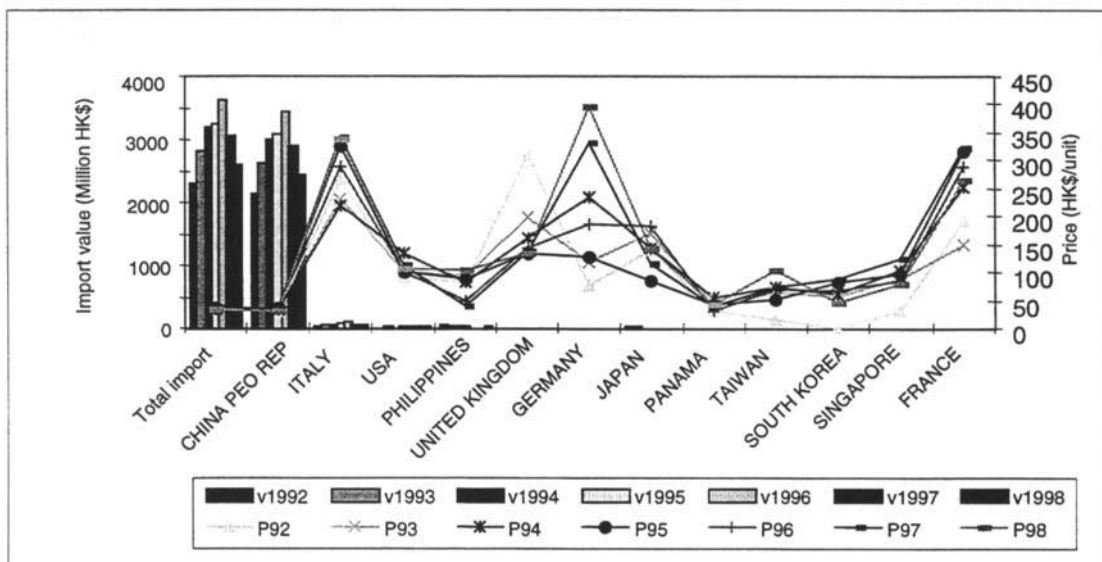
#### 4.2.3 Denim apparel in Hong Kong market and re-export through Hong Kong

##### *Hong Kong denim apparel imports*

Denim apparel is an important category of denim products imported into Hong Kong, and accounted for 66 to 72 per cent of total denim products imported between 1992 and 1998. Hong Kong imported HK\$ 2.3 billion worth of denim apparel in 1992. The import value peaked in 1996 with HK\$ 3.6 billion, increasing by 14.4 per cent every year from 1992 to 1996 on average. Hong Kong import values fell sharply in the next two years, when it imported HK\$ 3.1 billion worth of denim apparel in 1997, and HK\$ 2.6 billion in 1998. (See Fig. 4.9)

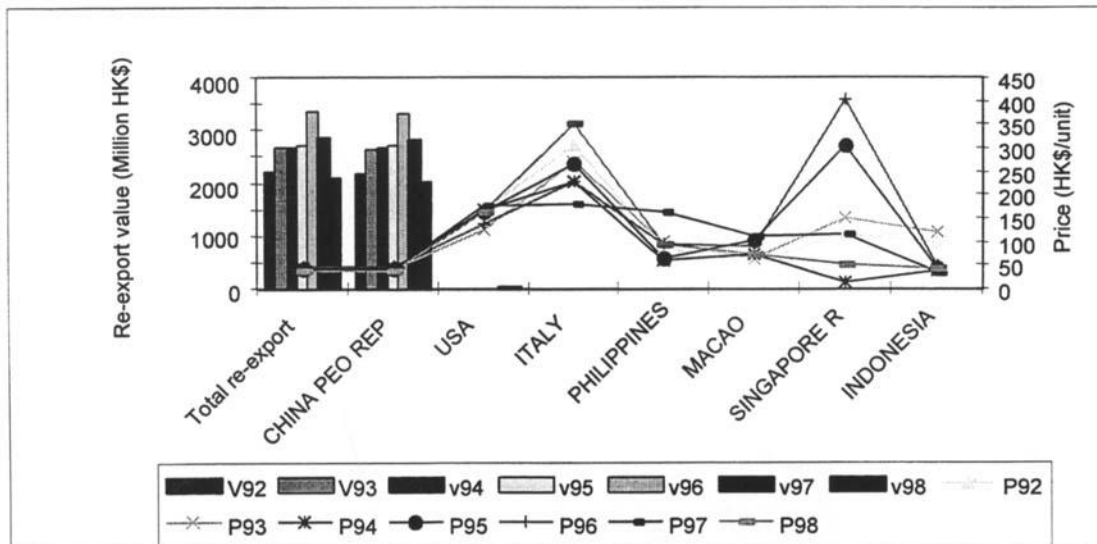
China was the most important source of Hong Kong imported denim apparel, and played such a dominant role that about 94 per cent of Hong Kong's imported denim apparel was from the Chinese Mainland between 1992 and 1998. (See Fig. 4.9)

The average price of Hong Kong imported denim apparel was from HK\$ 31 to 37 HK\$ per unit in the investigation period. The price of denim apparel from the Chinese Mainland was very low at HK\$ 30-odd per unit. The denim apparel from the second most important exporter—Italy--was above HK\$ 330 per unit, from Germany was close to HK\$ 400 per unit, and from France was HK\$ 265 per unit. In the Hong Kong market, apparel from US, United Kingdom and China Taiwan was above HK\$ 100 per unit. China's products thus belong to the low ground in the Hong Kong market. (See Fig. 4.9)



4.9 Hong Kong denim apparel imports





4.10 Hong Kong denim apparel re-exports by origin

### *Re-export through Hong Kong*

More than HK\$ 3.3 billion worth of denim apparel was exported via Hong Kong to overseas markets in 1996, which was the peak between 1992 and 1998. The Chinese Mainland was the most important source of Hong Kong denim apparel re-exports. In 1998 HK\$ 2.0 billion worth of denim apparel went to other countries via Hong Kong from the Chinese Mainland, accounting for 97.0 per cent of Hong Kong denim apparel re-exports. (See Fig. 4.10)

The price of denim apparel from the Chinese Mainland was around HK\$ 36 to 47 per unit; compared with the USA (HK\$ 160 per unit), Italy (HK\$ 350 per unit) this was relatively low. Denim apparel from the Philippines, Macao, Singapore and Indonesia were sold at HK\$ 95, 71, 50 and 43 per unit in 1998, respectively. (See Fig. 4.10)

Hong Kong and Macao are the two areas through which most China textile products are re-exported. To restrict Chinese made textile and apparel products via Hong Kong and Macao being exported to the US, the US rules of origin for imported textile and apparel products took effect in July 1996. The US rules of origin changed the factor which determines the country of origin of product from the country of cutting to the country of assembly, as part of the Uruguay Round Implementing legislation passed by the US in late 1994.

The following are the additional documentation requirements to the textile and apparel products to US exported from Hong Kong and Macao:

1. All importations of products the new rules affect must be accompanied by an original textile declaration signed by the manufacturer or subcontractor, ie, the actual producer of the merchandise (textile declarations signed by an exporter who is not the actual producer and those signed by importers will no longer be accepted);
2. A signed statement by the importer that such origin declaration is accurate;
3. A single entry bond for all entries.

4. Conditional releases for up to 180-days. USA Customs has up to 30 days after the end of a conditional period in which to request redelivery. Therefore, redelivery can be requested up to 210 days after entry.
5. In the event that a USA Customs verification team is in Hong Kong, all merchandise will be detained until production is physically verified.

The new requirement was effective for the items in the following textile quota categories: 336, 636, 342, 442, 642, 351, 352, 652, 443, 643, 331, 338/339, 348, and 350. In these categories, four items of denim product are included. They are:

Under category 348, item 6204624010, Women's trousers & breeches of cotton blue denim, not knitted and item 6204624040, Girl's trousers of cotton blue denim, not Imp playsuit OT, not knitted;

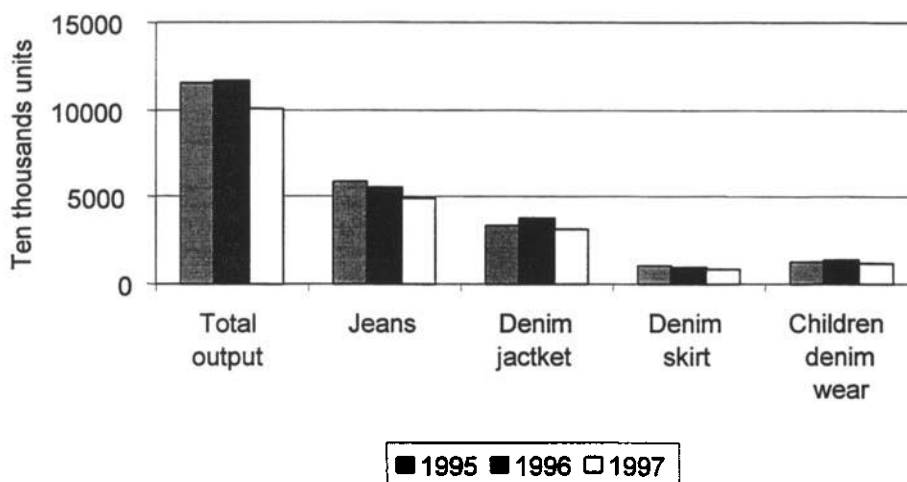
Under category 342, item 6204522030, Women's skirts & divided skirts of cotton blue denim, not knitted; and item 6204522040, Girls' skirts & divided skirts of blue denim, not knitted;

The rule significantly influenced Chinese denim apparel access to overseas markets via Hong Kong in the next few years. Although the new requirement had no significant negative effect on China's denim apparel export/re-export to/via Hong Kong in 1996, export/re-exports in 1996 grew sharply. However, the export/re-exports to/via Hong Kong shrank in the following years.

In 1997 and 1998, the Asian financial crises loomed. China and Hong Kong were the few countries (area) to keep their currency stable, when many countries devalued their currency to gain export competitiveness in the international market. The steady currency of China and Hong Kong brought huge pressures for denim product exports. After the above analysis of Chinese denim apparel performance in the three markets, features of Chinese denim apparel in world markets can be pointed out. The competitiveness of the Chinese denim apparel sector was stronger than that of the Chinese denim fabric sector. In 1997, China exported US\$ 37 million worth of denim apparel to the US, US \$20 million to the EU, US\$ 372 million to Hong Kong and US\$ 359 million via Hong Kong to other countries. Hong Kong was the most important market and a channel to access overseas markets for China's denim apparel industry. Denim apparel in the three markets exhibits different features and China's denim apparel has had different experiences. Denim apparel is fashion-oriented in the EU market, and China denim apparel has little market share there. In the US market, denim apparel was regarded as the uniform of America and a symbol of the American lifestyle. It was basic rather than fashion, so again denim apparel from China has only a small market share. Except for an abundance of denim apparel re-exported through Hong Kong, there is also much low price denim apparel exported to the Hong Kong domestic market. Denim apparel made in is basic rather than of interesting fashion. It was strong in competing in low price markets, but weak in competing in the high fashion, high value-added market.

#### **4.2.4 Domestic market**

Denim apparel has appeared in China's garment market since the 1980's. Nowadays, denim apparel has become very popular in China. It was reported that in 35 large China domestic department stores from January to October 1994, the sales volume of denim apparel reached 5 million units [3]. China's domestic market grew very quickly between 1995 and 1997; in particular, from 1995 to 1996 the market size



4.11 China denim apparel products output

grew from 45 million units to 62 million-- an increase of 38.6 per cent. In 1997, 64 million units of denim apparel were sold in the Chinese domestic market, indicating that denim apparel has a bright future in China.

#### 4.3 PRODUCTION OF MAJOR DENIM PRODUCTS

The main products of the Chinese denim apparel industry are jeans, denim jackets, denim skirts and children's denim wear. (See Fig. 4.11)

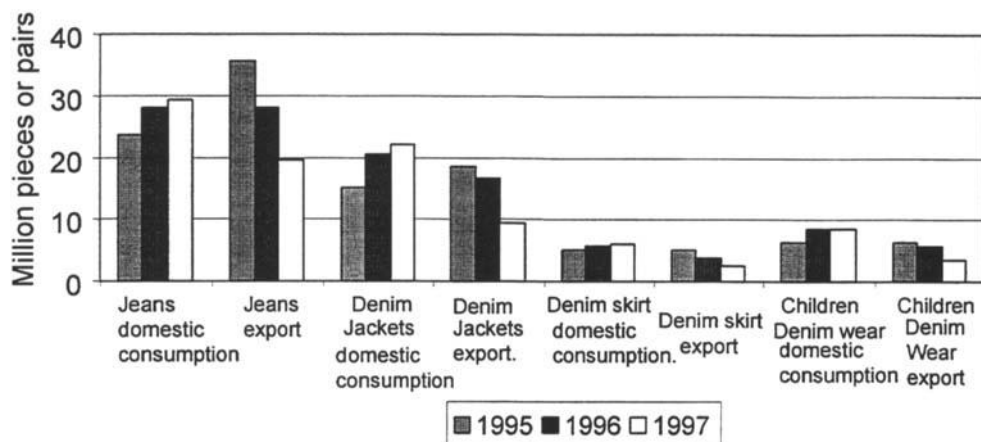
Jeans is an important apparel product category in China, and accounts for half of total denim apparel production. Jeans production in China reduced from 59 million units in 1995 to 49 million units in 1997, a reduction of 5.8 per cent per year.

The production of denim jackets was 33.6 million units in 1995, increased to 37.3 million units in 1996, and fell to 31.7 million units in 1997. The production of denim jackets accounted for about one third of total denim apparel production.

Children's denim apparel is also a major product of China's denim apparel production. Manufacturers produced 12.5 million units of children denim apparel in 1995, and this grew to 14.0 million units in 1996, falling to 11.9 million units in 1997. Children's denim apparel accounted for an average of 11.6 per cent of denim apparel production between 1995 and 1997.

In 1995, 10.3 million units of denim skirts were produced in China, reducing to 8.6 million units in 1997, a reduction of 5.3 per cent per year.

In the last few years, the structure of China denim apparel products has not changed very much. Jeans are still the most important products though their market share reduced from 51.2 per cent in 1995 to 48.3 per cent in 1997. Denim jackets became more important, their market share increasing from 29.1 to 31.3 per cent from 1995 to 1997. Children's denim apparel increased by one percent and denim skirts fell by 0.3 percent. Influenced by the declining overseas market, the production of jeans and jackets decreased, especially jeans. The production of children's denim apparel and denim skirts was kept steady, compared with jeans and jackets.



4.12 Sales of major denim products

#### 4.4 SALES OF MAJOR DENIM PRODUCTS

##### *Jeans*

The domestic market for jeans grew strongly in the past few years. The market size increased from 23.6 million units in 1995 to 29.3 million units in 1997. About 40 per cent of all jeans' output was sold in domestic markets in 1995, increasing to 60 per cent in 1997. Jeans in China's domestic market are getting more and more important. On the other hand, their foreign market has declined. The exported volume was 35.5 million units in 1995, but fell to 19.5 million units in 1997, by 15.0 per cent per year. Jeans exports accounted for 60 per cent of total jeans sales in 1995, but fell to 40 per cent in 1997. (See Fig. 4.12)

##### *Denim jackets*

Denim jackets are the second most important item of denim apparel in China. 45 per cent of denim jackets were sold in the Chinese domestic market, volume being 15.1 million units in 1995. In 1997, 22.2 million units of denim jackets (70 per cent of total denim jacket production) were consumed in the domestic market. The average growth rate of domestic market size was thus 15.7 per cent per year. Conversely, the overseas market for denim jackets declined between 1995 and 1997. The exported volume was 18.5 million units in 1995, but fell to 9.5 million units in 1997, a reduction of 16.2 per cent per year. In 1995, more than one half of denim jackets were exported, but the proportion decreased to less than one third in 1997. (See Fig. 4.12)

##### *Children's denim apparel*

In 1995, 6.3 million units of children's denim apparel were sold in the Chinese domestic market, accounting for one half of the total Chinese children's denim apparel output. In 1997, the volume increased to 8.4 million units, accounting for 70 per cent of total output. On the other hand, its export market size shrank from 6.3 million units in 1995 to 3.6 million units in 1997. (See Fig. 4.12)

##### *Denim skirts*

In 1995, the size of the domestic and foreign market were similar, each of them accounting for half of production. About 5.1 million units of denim skirts were

exported and the same volume was sold in the domestic market. In 1997, about 6 million units of denim skirts were sold in the domestic market, accounting for 70 per cent of total denim skirt production. Denim skirt exports thus accounted for 30 per cent of total output, with a volume of 2.6 million units. (See Fig. 4.12)

We can see that the domestic markets for all denim apparel products, has become larger than their overseas markets. The domestic market thus becomes more and more important for China's denim apparel industry.

#### **4.5 PRODUCTION AND SALES BY REGION**

Figure 4.13 shows the geographic distribution of Chinese denim apparel production and sales in 1997. There were 437 denim apparel manufactures in China, distributed in 26 province, 193 in Guangdong, 71 in Fujian, 32 in Shandong, and 30 in Jiangsu.

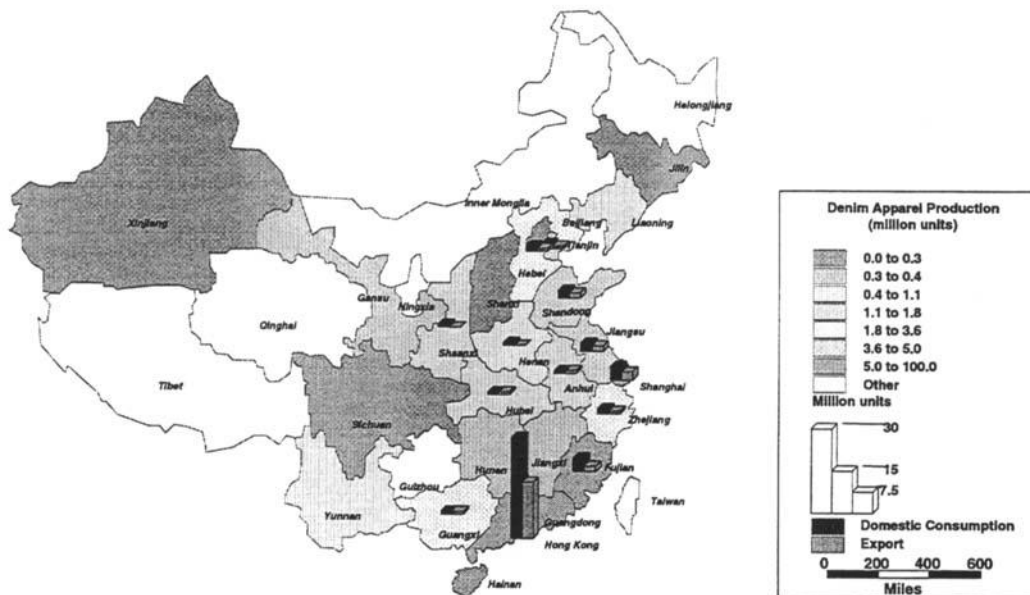
Guangdong Province leads the production of denim apparel products. Between 1995 and 1997, more than 56 per cent of Chinese denim apparel production was from Guangdong. Shanghai and Fujian were the other two important denim apparel production bases in China after Guangdong, with shares of about 7.6 per cent and 6.9 per cent, respectively, of total Chinese denim apparel output from 1995 to 1997. Jiangsu and Shandong Provinces were the most important production bases following the top three, accounting for more than 5.0 per cent and 4.5 per cent respectively of China total denim apparel production. (See Fig. 4.13)

Guangdong produced 66 million units of denim apparel in 1996, but the production decreased to 57 million units in 1997, a fall of 13.9 per cent. In 1995, 11.9 million units were sold in the domestic market and 27.8 million units exported. In 1997, 36 million units of denim apparel from Guangdong were sold in the domestic market, but export trade decreased to 19.8 million units. Thus the domestic market increased sharply, while the foreign market shrank considerably. (See Fig. 4.13)

Shanghai produced 8.8 million units of denim apparel in 1995 and 7.4 million units in 1997, accounting for 7.5 per cent of China's denim apparel output between 1995 and 1997, on average. Its domestic market increased from 3.7 million units in 1995 to 4.8 million units in 1997, but exports fell from 5.0 million units in 1995 to 2.7 million units in 1997. (See Fig. 4.13)

Fujian produced 8.2 million units of denim apparel in 1995 and 7 million units in 1997. Fujian's production accounted for an average of about 7 per cent of China total denim apparel output between 1995 and 1997. Its domestic market sales volume increased from 3.2 million units in 1995 to 4.5 million units in 1997, while its exports declined from 4.6 million units in 1995 to 2.4 million units in 1997. (See Fig. 4.13)

About 4.7 per cent of China's denim apparel output came from Jiangsu between 1995 and 1997 on average. Jiangsu produced 5.5 million units in 1995 and 4.9 million units in 1997, exporting 3.1 million units of denim apparel in 1995 but only 1.7 million units in 1997. In the Chinese domestic market, about 2.3 million units of denim apparel came from Jiangsu in 1995 and 3.0 million units in 1997. (See Fig. 4.13)



#### 4.13 Denim apparel production by region

Shandong produced 4.8 million units in 1995 and 4.6 million units in 1997, accounting for 4.1- 4.5 per cent of Chinese denim apparel production. In 1997, 2.9 million units of denim apparel from Shandong Province were sold in the Chinese domestic market, but exports fell from 2.7 million units in 1995 to 1.6 million units in 1997. (See Fig. 4.13)

These five provinces produced 80 per cent of China's denim apparel output, whose production is thus concentrated in the southern and eastern region of China. The domestic market grew sharply in the years under study, while exports declined significantly.

#### 4.6 INDUSTRIAL DEVELOPMENT AND MANAGEMENT IMPLICATIONS

The garment industry is one of China's leading foreign exchange earners. The Chinese government has implemented several successful policies in the garments sector to help industry development and growth in the past few years. These include: (1) Special loan packages to garment factories. (2) Favorable policies for foreign-funded garment factories. (3) Export tax rebates and export subsidies. (4) Development of the garment-reprocessing sector and border trade. (5) Low-interest loans for technology upgrades. (6) Reform of the garment quota allocation system. (7) Granting garment factories import and export rights. (8) Encouraging garment retailing and wholesaling in the private sector [4].

Most Chinese denim apparel factories are in the small or of medium size. Shortage of capital is the major problem they faced, which prevents the factories from updating machinery, developing technology, and promoting marketing. Policies (1) and (5) help the factories to get lone capital from the bank, speed the industry's technological development and machinery updating, and to apply marketing skills to promote their products. The implication of other policies will be discussed below.

#### **4.6.1 Export subsidies and export rebate**

Export subsidies, according the *Dictionary of International Trade* [5], are described as: " (1) Payments made by a government to companies that export specific goods to encourage them to compete in foreign markets. (2) Government benefits made available to domestic producers of goods contingent on their exporting those items for which the benefits received apply. These include support prices, tax incentives, etc. (3) any form of government payment or benefit to an exporter or manufacturing concern contingent on the export of goods."

Under GATT, subsidies, especially export subsidies, are seen as a tool that distorts the normal behavior of the market. The Tokyo Round produced an agreement on subsidies and countervailing duties that prohibits export subsidies by developed countries on manufactured and semi-manufactured goods. On the other hand, GATT permits less developed countries to subsidize their export manufactures provided that significant material damage does not result to the economies of highly developed countries as consequence. Subsidies usually take an indirect form (e.g. R&D support, tax breaks, loans on preferential terms, and provision of raw materials at below-market prices).

Export subsidies applied to China's denim apparel producers will provide an opportunity to develop their technology and update their machinery, and promote the development of the denim industry.

Export rebates occur when government pays back or exempts some tax to the domestic manufacturers when they export goods, to encourage exports and enhance the competitiveness of domestic products in the international market. It is a kind of export subsidy though there are different views about this. Export rebates were always regarded as a tool to stimulate domestic exports, especially for the textile and garment sectors. Export rebates widely exist in many countries.

Before 1997, the tax rebates for textiles products declined from 17 to 14 per cent, then to 9 per cent, and the textile products exporters had to face declining profit margins. In 1997, a financial Crisis erupted in most Asia countries and caused their currency to be devaluated. Among these countries, some are important garment exporters, such as South Korea, Thailand, and Indonesia. China, as the country that kept the exchange rate steady, found its garment exports facing huge pressure because of the other countries' devaluation, and garment exports decline in 1998 and the first half of 1999. To encourage textile products exports, the State Administration of Taxation of China increased the rebate rate of textile products in order to boost exports. The tax rebates for apparel and textile machinery were increased to 17 per cent in January 1, 1998, and tax rebates for other textile products were also increased between 1998 and 1999. While the tax rebate rate for garments was raised to 17 per cent, the tax rebates for textile raw materials and fabric were increased to 15 per cent. As China's official value-added tax on exports is 17 per cent, the current tax rebate rate means that exported garments enjoy a full tax refund. Thus, the barrier to exports was reduced and allowed Chinese exporters to compete in foreign markets with less pressure arising from the devaluation by other countries.

#### **4.6.2 Internal export quota management system**

China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) promulgated Rules for the Implementation of Methods of Export Quota Bidding with

Compensation on April 29, 1996. For the Chinese textile and clothing sectors, the new rules were significantly expanded and modified a program that was established on a limited, trial basis several years ago.

The experimental bidding system, initiated in 1994, covered just four minor quota categories (T/C bleached goods, cotton bleached goods, ramie yarn and ramie gray). That program has now been expanded to cover the following very important categories:

- 334 (cotton overcoats—men's and boy's)
- 347/348 (cotton trousers, slacks and shorts—men's, women's, boys' and girls')
- 351 (cotton night gowns and pyjamas)
- 352 (cotton underwear)
- 634/635 (manmade fibre overcoats— men's, women's, boys' and girls')
- 636 (manmade fibre dress)
- 638/639 (manmade fibre knitted shirts/blouses-- men's, women's, boys' and girls')
- 641 (manmade fibre non-knitted shirts and blouses—women's and girls')
- 645/646 (manmade fibre sweaters—men's women's boys' and girls')
- 647 (manmade fibre trousers, slacks and shorts—men's and boys')
- 652 (manmade fibre underwear)
- 840 (linen and cotton shuttle-woven blouses)

In China, under the expanded system, an organization called the Bidding Committee for Quotas of Export Commodities, undertakes the responsibilities of handling the bidding for export quotas with compensation. The Bidding Committee is accountable to the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), and regional departments (commissions, bureaus) of foreign trade and economic cooperation undertake the responsibility for advertising and organizing the bidding in their localities.

All quotas for the affected textile categories is to be sold through a bidding process, with 60% of the quota subject to 'open bidding' and 40% to 'bidding by agreement'. Bidding by agreement differ from open (public) bidding in that it is reserved for former state-owned companies with past-performance records, who are-guaranteed quota in the phase.

The bidding enterprises have to pass a series of qualifications, such as that the export commodity manufacturing enterprise applying for public bidding should mainly concentrate on a certain commodity, even though the enterprise has no export performance. Foreign-funded enterprises which have joined the Foreign-Funded Enterprises Association, and enterprises which have been checked and accredited by MOFTEC with the right to do border trade of small quantity, may participate in public bidding.

Eligibility for bidding by agreement will be determined by a MOFTEC-established "Bidding Office", based on the volume of a company's textile exports to the US prior to implementation of the relevant import restriction. As noted above, bidding by agreement is reserved for companies with past-performance records, such as the provincial authorities which traditionally issue visaed invoices in their names.

Under the new bidding system, bids are submitted simultaneously by facsimile and mail within deadlines established by the administering authorities. While prices in open bidding are to be decided by the participating companies, that Bidding Office has the discretion to set minimum prices or reject offers which obviously deviate from "normal price levels." In bidding by agreement, the Bidding Office will announce the



maximum volume that a company may did for, based on the volume the company was granted in the previous year's bidding by agreement, less (i) any amount of quota the company returned to MOFTEC or transferred to another company in the previous year, and (ii) double the amount of quota "wasted" by the company in the previous year (a company will be considered to have "wasted" quota in the same category for two to three years; where the wasted quota was received in bidding by agreement, volume limitation will be imposed).

Under the new quota system, export quota users could use export quota on a relatively equal footing through public quota bidding. However, after study the effect of the new quota system to the Chinese textile and clothing industry, some scholars indicated that the new quota system will likely have an inflationary effect on the price of goods in the affected categories, because those factories or shippers which are receiving the highest prices for their goods should be better able to absorb the additional cost of obtaining quota [6].

Denim apparel manufacturers or exporters, (like other textile products manufacturers or exporters,) gain quotas by bidding. The reform of the textile quota system, aims to phase out the "life-time system" and to introduce a system of public bidding for quotas of quality consumer goods which are in high demand but short supply. According to this policy, quotas of sixty percent in each of 21 categories of textile products, including pants and T-shirts, exported to the United States, were open to public bidding. Quota system reform is intended to favor textile manufacturing and research enterprises over foreign trade, which previously controlled the most quotas.

However, the policy has caused some problems, such as waste of quotas and increasing costs. Because of management problems, many manufacturing and research enterprises that won the bidding could not fill their quotas by the end of the year. Whether because these enterprises did not turn their surplus quotas over to higher authorities, or because the government did not adequately supervise quota use, quotas were often wasted, and enterprises which needed quotas could then take them up. Meanwhile, because enterprises had to win intense bidding for quotas of consumer goods, the cost of products increased and, as a result, the power of China's textiles to compete in a global market was greatly weakened. Because of this, China's Ministry of Foreign Trade and Cooperation is planning to inquire into the present textile export quota system and is considering appropriate adjustments [7].

The government holds an annual auction to sell off the textile export quotas allotted to it by other nations. To develop China's textile foreign trade, the Chinese government took its textile-quota bidding process online as a sign that e-commerce is beginning to emerge in China, according to the October 20 *Zhongguo Maoyi Bao* (China Trade News). The e-auction attracted over 2,000 companies, of which 95 per cent successfully submitted electronic bids [8]. The program will usher in a new "e-commerce business era."

#### **4.6.3 China promotes medium and small enterprises**

Medium and small enterprises play an important role in the China apparel industry and other labor-intensive industries [9]. Under the standard modified by the State Economic and Trade Commission in 1998, medium and small enterprises are those with total assets or sales revenue of RMB 50 million (US\$ 6million) a year or less. Medium and small enterprise are responsible for almost all of the clothing, toys, crafts, and other labor-intensive goods produced in mass quantities for export in

China. More than 80 per cent of China's small and medium enterprises deal with apparel, leather, stationery, sports products, plastic goods, and metal products.

Developing medium and small enterprises was one of main objectives for China's industrial development in 1999, as determined by the Central Economic Working Conference held at the end of 1998. The policy of promoting medium and small enterprises outside the framework of the state ownership system began in 1998. In 1999, the policy makers decided to adopt more effective policies and measures to promote the development of these enterprises [9]. These included the establishment of a principal lender for medium and small enterprises, (the China Minsheng Bank in 1996, the Medium and Small Enterprises Service Center in Shanghai in 1998,) and a credit guarantee fund for medium and small enterprises in Beijing. The State Economic and Trade Commission's "Guidance for the Establishment of the Credit Collateral System for Medium and Small Enterprises" and a meeting on loan credit guarantees for medium and small enterprises, reported on the enactment of the "Loan Credit Service Management Regulations" [9].

#### **4.6.4 Open market**

The globalization of the world economy has grown up since the 1980s. Globalization reflects the increasing interdependence of world society [10] (p. 528), and involves the substantial internationalization or regionalization of an activity previously handled in a single-country context [11] (p. 37).

Globalization can be traced back to the sixteenth century and the spread of imperialism and capitalism across the globe. As a result of globalization, States and societies are more interconnected and thus more interdependent [12], and the borderline of their economies have become fuzzy.

Under such a more 'open' world economy environment, China launched an 'opening' policy at the end of the 1970s. China, is no longer as an enclosed ancient eastern country, but a modern reforming new market economy, playing a more and more important role in the global economy. The Chinese market was opened step by step by allowing foreign companies enter to the Chinese domestic manufacturing, investing, retailing, capital, etc. sectors. The trade barriers were also removed by tariff cutting, permitting more foreign products to enter China.

For denim apparel, two aspects of reform brought challenges from the foreign competitors. They were tariff cutting and the elimination of tariff barriers.

#### *Tariff cuts*

Until the mid-1990s, China's tariffs were often high enough to preclude most imports. China has taken steps to reduce tariffs pursuant to its bilateral commitments and to support its WTO accession bid. In 1996, China lowered its average import tariff from 42.1 percent to 23 percent, and on October 1, 1997, further lowered the average import tariff to 17 percent. Effective from January 1, 1999, further tariffs for 1,014 products in the forestry, textile and toy sectors were cut. In the textile sector, tariffs were reduced on fabric, clothing, and textile products for industry use and packaging materials. The reductions decreased the average textile tariff from 27 to 25 per cent [13].

### *Non-tariff barriers elimination*

Licensing, quotas, tendering, transparency, national treatment, judicial review, state trading, offsets, transfer and protection of technology, local content, export performance, and trade and foreign exchange balancing requirements were regarded as the principal types of China's non-tariff barriers [14]. Among these, licensing and quotas were the major two kinds of barrier. Under China's Foreign Trade Law, certain products are subject to quotas and import and/or export licensing. Licensing and quotas overlap in many product sectors. Licenses are issued based upon the justifications to import given by the applicant, stating that the import is necessary and also that the applicant has the necessary foreign exchange. The value or quantity levels of quotas on imported products are not publicized, and there is little transparency.

With the opening of its market more and more, China has hammered at eliminating its non-tariff barriers to become a member of the WTO. Import licenses on many products have been eliminated, and the process for license application has been simplified. China has also reduced the number of products subject to quota management. In the near future, when China becomes a member of the WTO, more non-tariff barriers will be eliminated. Although apparel is still one of the 246 Chinese tariff HS subheadings subject to import quota management [14], the volume of import quotas may be improved.

Tariff cutting and the elimination of non-tariff barriers will allow greater foreign denim apparel access to China domestic market. Meanwhile, foreign products can compete with the China domestic products at lower prices. While Chinese domestic producers concentrate on the low-middle class market, high-tech foreign companies with their sophisticated marketing experience, and well designed apparel will occupy a big part of the Chinese high-class apparel market.

As China opens its market more and more, more foreign manufacturer will enter this huge market, and Chinese domestic producers will compete with foreign competitors in the domestic market with the little protection. Domestic producers will face challenges from foreign competitors, who own huge capital, sophisticated marketing skills, and state-of-the-art technology.

## **SUMMARY**

China owns huge denim apparel capacity, mainly distributed along coastal areas. Hong Kong is the most important market, and is the most important channel for accessing overseas markets. The products of the China denim apparel industry belong to the low value category. It has competitive advantage in low price markets but not in the high value-added and fashion-orient market.

The Chinese government has shaped the industry's course to promote the industry's development. With the open market policy of the country, the denim apparel industry is facing stiff competition from foreign competitors, not only in the overseas market, but also in its domestic market.

## REFERENCES

1. WHITE, J., *The great American fabric evolves to meet the late '90s // CLOTHES: New technology and new styles help keep denim as popular as ever*, in *Knight-Ridder Newspapers (The Orange County Register)*. 09/19/1997. p. E03.
2. Ferre, E., *The Mediterranean alternative*. Textile Asia, 1992. January: p. 137-140.
3. Anon, *Jeans fashions in ascendant*. JTN-Monthly, 1995.484, p. 75-77.
4. Anon., *China's Garment Industry Wrap-up*, 1998, [http://www.chinaonline.com/industry/consumer/newsarchive/secure/1998/december/cn\\_b8121708.asp](http://www.chinaonline.com/industry/consumer/newsarchive/secure/1998/december/cn_b8121708.asp)
5. Rosenberg, J.M., *Dictionary of International Trade*. 1994, New York: J. Wiley. 121.
6. Horowitz, R.L.E.a.P.A., *China's new quota system*. Textile Asia, 1999. XXX(2): p. 39-41.
7. Anon, *China To Change Textile Export Quota Arrangement*. 1999, China online. [http://www.chinaonline.com/issues/foreign\\_relations/currentnews/secure/c9101806.asp](http://www.chinaonline.com/issues/foreign_relations/currentnews/secure/c9101806.asp)
8. Anon, *China Conducts Textile Quota Auction Online*. 1999, China Online. [http://www.chinaonline.com/industry/infotech/newsarchive/secure/1998/october/it\\_b8102137.asp](http://www.chinaonline.com/industry/infotech/newsarchive/secure/1998/october/it_b8102137.asp)
9. Uehara, K., *China Promotes Medium and Small-Sized Enterprises*. 1999, China Online. <http://www.chinaonline.com/commentary-ana...cs/currentnews/open/c9082670uehara-ss.asp>
10. Giddens, A., *Sociology*. 1993, Cambridge: Polity Press.
11. Unleavy, P.a.H., C, *From old public administration to new public management*. Public Money & Management, 1994. 14(No. 3).
12. Stephen Cope, F.L.a.P.S., *Globalization, new public management and the enabling State*. International Journal of Public Sector Management, 1997. 10(No. 6): p. 444-460.
13. Anon., *China Drops Selected Import Tariffs*. 1999, China Online. [http://www.chinaonline.com/issues/econ\\_news/newsarchive/secure/1999/january/en\\_b9011808.asp](http://www.chinaonline.com/issues/econ_news/newsarchive/secure/1999/january/en_b9011808.asp)
14. Arona Butcher., *Assessment of the Economic Effects on the United States of China's Accession to the WTO*, . 1999, US International Trade Commission: Washington DC. p. 3-1.