

IS FREE TRADE WITH CHINA IN PERIL?

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Abstract

The 3-year-period for textile-specific safeguards adopted on the basis of the Textile Specific Safeguard Clause (TSSC) following China's accession to the World Trade Organization will expire on 31 December 2008. Therefore, textiles and clothing from China will be granted access to the United States of America and European Union markets free from quota restrictions or supervision. Or will they? A similar scenario existed in 2004. The planned liberalisation of trade in textiles in 2005 (following a 10-year transition period) was suspended due to the successful lobbying of protectionist groups in Brussels and Washington. The result was legal chaos (especially within the European Union), and the economic fallout for importers was enormous. This paper describes the economic situation and legal steps taken in 2004 in order to warn against a repetition of these events in or after 2008.

I. Introduction

On 6 December 2006, the European Commission adopted a Green Paper¹ for public consultation on Europe's trade defence instruments in a changing global economy. Many European companies nowadays produce goods outside the European Union (EU) for import into the EU, or operate supply chains that stretch beyond the European market. These changes challenge familiar understanding of what constitutes EU production and the EU's economic interests. The challenge is always to find the difficult balance between retailer, importer, producer and consumer interests. Trade defence instruments which were thought to protect EU companies may be more harmful to EU companies and consumers than an effective response to unfair trading practices.

A good example of how disastrous the consequences of trade defence instruments can be was provided in the summer of 2005 when the EU adopted new quantitative restrictions for the imports of textiles and clothing originating in China. From July 2005, more than 80 million pieces of clothing which had been bought and paid for by the European importers were left stranded in European harbours. Importers were faced with considerable costs, and had difficulties in fulfilling the contracts agreed with their customers.

II. Quantitative restrictions in the textiles and clothing trade

Cross-border trade in textiles and clothing has traditionally been subject to exceptionally restrictive trading rules. This is largely due to early globalisation trends in the clothing industry caused by outsourcing labour-intensive activities.

In addition to exceptionally high customs duties, quantitative restrictions (contingents, which are allocated in quotas) were employed on a particularly large scale in order to regulate commodity flows. According to the Organisation for Economic Co-operation and Development (OECD), textiles and clothing are the only commodities regularly subject to import quotas in the interests of safeguarding local industry. The first specific international rules were already in existence in 1961 (GATT Cotton Arrangement). The

'Multifibre Arrangement', the predecessor to the WTO Agreement on Textiles and Clothing (ATC) of 1995, has been in existence since 1974. The object of these quota systems was the quantitative restriction of market access in industrial countries of the EU, the USA and Canada for textile and clothing products originating in developing and emerging countries, the main focus being on Asia and Eastern Europe.

The intention of the ATC was to abolish the specific rules for textiles and clothing and integrate such products into the normal WTO rules. This was to be accomplished via a gradual liberalisation of the restricted textile categories in a 10-year plan.

The following procedure was defined for the liberalisation:

- 1.1.1995 Liberalisation of 16% of the total import volume
- 1.1.1998 Liberalisation of a further 17% of the total import volume
- 1.1.2002 Liberalisation of a further 18% of the total import value
- 1.1.2005 Full liberalisation.

During these phases, provision was made for a safeguard clause which permitted the reintroduction of quotas should domestic industry come under threat. Although the United States (US) invoked this rule in 2003 in respect of three product categories, the EU has never done so.

The allocation and administration of quotas is based on so-called 'textile categories' which combine customs tariff numbers for commodities within a specific textile or clothing product group. Unfortunately, the EU and the USA have adopted different approaches in this respect. Whereas the EU combines identical commodities of different material composition² (for example, men's or boys' and women's or girls' woven trousers made of wool, cotton or man-made fibres belong to EU category 6), the US textile categories do not refer to either material or gender (for example, the categories for trousers are 347 (M/B, cotton), 348 (W/G, cotton), 447 (M/B, wool), 448 (W/G, wool), 647 (M/B, man-made fibres) and 648 (W/G, man-made fibres).

III. Effect of quota decisions relating to production and procurement

The effects of the quota systems on production and location decisions, as well as on the procurement strategies of European and American importers, were enormous. Exceptionally affected was clothing manufacture, which, due to the low automation level and resulting high wage and salary costs, is particularly predestined for relocation to low-wage countries. The very capital-intensive textile production was less affected by relocations.

Quantitative restrictions also hindered procurement from traditionally prolific manufacturing countries such as China or India. In addition to a sufficiently low-cost and well-qualified workforce, these countries also possessed the necessary textile precursor materials such as yarn or fabric. The quota system caused the available quantity to run short, but it also particularly led to an artificial increase in the price of the commodities, as a lucrative official and unofficial quota trade quickly established itself. The additional costs for this 'right to export' sometimes reached as much as 50% of the price: for T-shirts in EU textile category 4 at times approximately USD 1 per item, and cashmere pullovers (EU category 5C) up to USD 20 per item. Based on these effects, quotas lead to a relocation of production to less competitive countries. In addition, the quota costs sometimes lead to a considerable increase in export prices.

This situation led to the creation of a clothing industry in low-wage countries which were not subject to any quantitative restrictions. Prime examples of this are Bangladesh and Cambodia which, in addition to exemption from quotas, also enjoy complete exemption from customs duties as part of the scheme of preferences for developing countries.

The result of this trade policy was the international fragmentation of clothing production. In the absence of available precursor materials in the production countries, such materials had to be provided partially

by Europe, and partially by Asia. Semi-finished clothing products were sent from restricted countries to non-quota countries in order to receive their finishing touches there, justifying their 'origin' and allowing non-quota import into the EU and the USA. In order to reduce the risk, importers were compelled to distribute their procurement sources among several countries. Suppliers were not selected for purely business or product-specific reasons; instead selection was essentially dependent on the exporter's available quotas. The results of such structures are higher production costs, longer throughput times, and extremely high administrative expenses.

Thus, not only was product know-how and market knowledge vital to a clothing importer's commercial success, but also the ability to deal professionally with the extensive trade restrictions. '... [S]kill at navigating the bureaucracy and using the levels of political influence became prerequisites for survival. ... Simply put, the rules are nuts, as even the people who made them easily agree. ... Trade policy for textiles and apparel took the seemingly irreversible step to a complexity that left it unintelligible to all but a few.'³

Import contingencies can also be criticised from an economic perspective. For example, Sauernheimer argues that 'Import contingencies benefit domestic producers and the owners of import licences, but are detrimental to domestic consumers. ... Contingencies have a greater trade-restricting and welfare-reducing effect than any customs duty. ... Import restrictions reduce domestic competitive intensity, thus contributing towards excessive prices and minimal demand for innovation. They have a structure-preserving effect. ... The distribution of income becomes politicised and politics are left open to blackmail'.⁴

IV. Developments arising from the expiry of the ATC

a. The situation regarding trade policy

The first three liberalisation stages, in 1995, 1998 and 2002, almost exclusively liberated textile categories of subordinate significance due to product procurement and business volumes. Particularly critical clothing products such as T-shirts, trousers and blouses were not liberalised until 2005. In retrospect, this procedure has to be designated as an error as the ATC's effect was not fully felt until then. Companies in the textile and clothing industry within the EU, particularly in still relatively high-production countries such as Italy, Spain and Portugal, remained unaffected, and thus adapted too late, or failed to adapt at all to the extensive changes to be expected on 1 January 2005.

Researchers and politicians (as well as industrial lobbies) failed to seriously consider the impact of the impending changes until the ATC had entered its final phase. A number of extensive studies and publications on the effects of quota liberalisation were published in 2003 and 2004,⁵ all of which reached the following conclusions:

- China and India would be among the most notable major winners.
- The ATC would disadvantage countries or customs territories which had previously benefited from the restrictions, including Bangladesh or Macao, whose exports had enjoyed preferential market access to industrialised countries on the basis of preferential agreements, as well as safeguard operations within the EU.

Some studies also refer to possible advantages for the consumer who, due to more cost-effective procurement options, is able to purchase at lower prices or receive higher quality commodities for the same price. Canada was the only market previously safeguarded by quotas to unswervingly implement quota liberalisation on 1 January 2005. There, in addition to the liberalisation for WTO member states, the still existing autonomous restrictions vis-à-vis non-WTO members were also abolished.

b. Economic situation

Quota liberalisation is not the only significant change that companies face at the beginning of the 21st century. Market demands, as well as organisational structures in industry and trade, are currently experiencing serious upheaval.

On the one hand, the business world is moving at an ever-increasing pace. Two annual fashion collections a year are history; at least four collections, together with additional trend programs, are the reality. Development, procurement and sales cycles are being progressively reduced. At the same time, the traditional division of tasks between industry (production development and production) and trade is increasingly disappearing. Vertical integration, which involves process-control ranging from product development through procurement and culminating in sales, is progressing rapidly. The traditional retail market, which continues to revolve around department and chain stores, procures commodities on its own initiative, while the industrial sector counters this by promoting its own sales. Discounters also exert pressure: in 2005, Aldi, Tchibo and Lidl occupied the 8th, 9th and 10th places in the annual rankings of major German textile retailers.⁶ Complete knowledge and control of internal procurement structures are becoming more important owing to more stringent labour and social standards as well as added security requirements. As a result, the importance of intermediate traders or agents has plummeted.

As far as production and procurement decisions are concerned, there is a need for faster throughput times and a concentration on fewer suppliers. Companies have to maintain a balance between speed (that is, more expensive production versus greater market proximity) and costs (that is, low-cost production in Asia versus longer delivery times).

V. China's accession to the WTO: reactions in Europe

The People's Republic of China (PRC) became a member of the WTO on 11 December 2001. This automatically meant China's integration in the ATC. By then, the changes that liberalisation would bring on 1 January 2005 must have been clear to all involved. Strategically thinking importers in the USA and the EU re-thought their procurement strategies and prepared to intensify their business relationships with China. For its part, China also improved its export capability by massively investing in the most recent textile technology. Parallel to the capacity expansion, the quality of many Chinese producers also considerably improved.

As of that date, at the latest, all the companies and industrial lobbies involved must have appreciated how imports would relocate towards China as of 2005. Yet, it took associations in the EU and the USA until 2003 or 2004 to address this topic, in order to then vehemently demand that existing trade restrictions be extended, or new ones introduced.

As expected, imports from China increased sharply in the first six months of 2005; parallel to this phenomenon, import prices fell. This was largely due to the abolition of quota costs. The USA and EU satisfied the requirements for applying the safeguard clause for textiles provided in the ATC in relation to important categories of imports from China. In Europe, the situation escalated to a ban on imports lasting for weeks, which affected approximately 80 million shipments, and assumed existence-threatening proportions for many importers. A significant reason for this was the Commission's Directorate General for Trade's lack of transparency in reintroducing safeguard measures.

In mid-2005, imports of specific categories into the EU were reallocated, initially until 31 December 2007. In the USA, the statutory limit for safeguard measures will expire on 31 December 2008.

VI. The legal basis for the reintroduction of trade restrictions

The ATC imposed an obligation on the EU to abolish the remaining quantitative restrictions for 210 categories of textile and clothing products. However, the euphoria that greeted the quota-free access to the EU market was short-lived because the EU applied the emergency brake no later than spring 2005. Following demands by textile manufacturers in the EU, the Commission requested consultations with the Chinese Government which led to the re-introduction of trade restrictions for textiles and clothing products within a matter of days.

The reintroduction of trade restrictions was justified on the grounds that, when it joined the WTO, China had granted specific safeguard measures for textiles and clothing products to all WTO members at that time, which departed from WTO rules and entitled them to apply unilateral measures for a transitional period of twelve years (which is due to expire on 11 December 2013). The legal provision at the root of the renewed quota dispute was Paragraph 242 of the Working Party Report (WPR) of the Accession of the PRC to the WTO⁷ which contained the Textile Specific Safeguard Clause (TSSC). This specific safeguard mechanism has been restricted to a period of seven years, and is due to expire on 31 December 2008.⁸

The TSSC contained in Paragraph 242 WPR can be applied 'where a WTO Member believed that imports of Chinese origin of textiles were, due to market disruption, threatening to impede the orderly development of trade in these products'. China accepted that, just on the basis of a request for consultations and as long as the consultations were pending, it would restrict its shipments of textiles and clothing products to the Member in question to an agreed amount. This resulted in an automatic and voluntary – although temporary – self-restraint for textile exports to the EU, which can better be seen as unilateral import restrictions imposed by EU.

VII. The compatibility of the TSSC with WTO law

The TSSC automatically raises the question of whether it stands in accordance with WTO rules. The question of WTO conformity must be assessed taking into account the multilateral principles of WTO law which are binding on all Members.

Evidence suggests that the quantitative restrictions of the TSSC breach the principle of tariffication (X:1)⁹ and that specific defences (especially Art. XI:2 of the GATT) do not apply. Moreover, the Safeguard Clause contravenes the principle of non-discrimination enshrined in Art. XIII:1 of the GATT¹⁰ even if all WTO Members can invoke the clause (and the USA has already done so), its application is restricted to a small number of trading partners and does not reflect the formula for allocating quotas contained in Art. XIII:2 of the GATT. The TSSC also leads to so-called 'voluntary' self-restraints¹¹ which belong to the grey-zone measures prohibited by Article 11.1(b) of the Agreement on Safeguards.¹² These voluntary self-restraints are anything but voluntary, because China would have been facing much more intense measures such as in the area of the exchange rate of the Renminbi, if it was not willing to yield to the pressure from Europe and the USA related to trade in textiles. Finally, self restraints effectively circumvent Art. XIX of the GATT as well as Art. 8 of the agreement on safeguards that would entitle exporting Members who would be affected by such a measure, to claim for compensation for the adverse effects of the measure on their trade.¹³ Moreover in the case of applying Art. XIX GATT, the MFN treatment obligation of Art. I:1 of the GATT must also be respected.¹⁴ The measures based on the safeguard clause undermine China's right to claim compensation, and are only applicable to imports from China but not from other textile exporting nations.

But also economic reasons stand against the TSSC: self restraint agreements create an insecure and unreliable trading climate. Grey zone measures, in particular, are macro-economically inefficient as the profit gain of importing competitors and of the exporters who have enhanced market access cannot

compensate the losses of the consumers who face increased prices. During the political debate for the introduction of new quantitative restrictions, 455 million consumers did not have a real lobby.

Measures which are not in accordance with WTO obligations may be justified under the specific situation of a new Member accessing the WTO. The accession of a country to the WTO applies fundamentally to all multilateral agreements of the WTO package (Art. XII:1 s. 2 of the WTO Agreement). In addition, Art. XIII of the WTO Agreement creates the possibility for a Member to prevent specific WTO rules from applying to its trade relations with another Member.¹⁵ This ‘opt-out’ clause has to be invoked at the time that the Member State in question joins the WTO. On the accession of a country to the WTO, existing Members do see the possibility to waive the application of individual parts of the multilateral agreements on a transitional basis (phase in or phase out).¹⁶ This kind of treatment of WTO obligations is, without any doubt, a breach of the single package approach.¹⁷ Even if it looks quite strange, the basis for such a waiver in international law may be found in Paragraph 242 WPR which forms, together with Paragraph 342 WPR and No. 1.2 of the protocol of accession, an integral and legally binding part of China’s obligations.¹⁸

VIII. The application of the TSSC

Specific questions arise if one looks at the handling of the TSSC by the EC. When questioning the lawfulness of the EC’s measures, a distinction must be drawn between the implementation and application of the safeguard clause in Community law.

a. Transposition into Community law

The Community legislator has literally transposed the TSSC contained in Paragraph 242 WPR by Regulation (EC) No. 138/2003¹⁹ which inserted a new Article 10a into Regulation (EEC) No. 3030/93.²⁰ On 6 April 2005, the Commission adopted indicative guidelines on the application of Article 10a of Regulation (EEC) No. 3030/93 concerning a textiles-specific safeguard clause (the Guidelines). The Guidelines describe how the Commission intends to handle the TSSC, and were published no earlier than 27 April 2005.²¹ In particular, the Guidelines stipulate the ‘alert levels’, clarifying that measures will not be taken into account if import levels are below those indicated in the alert levels. The Commission points out that the purpose of the Guidelines is to inform interested parties and not to create legally binding standards. Considering the *numerus clausus* of legally binding acts given by the Community (regulation, directive and decision pursuant to Art. 249 EC-Treaty), this fact should be seen as obvious. Despite this announcement, the Guidelines will have a de facto binding character, as they demonstrate how the external relations between Commission and economic operators will be configured. The Commission itself sees the TSSC as a ‘particularly vaguely worded provision which can be applied with a relatively wide margin of discretion’, and only in conjunction with the Guidelines any economic operator in the EU will get an indication of the way the Commission intends to apply the TSSC giving, at least, some reliable basis for further business with China.

b. Application in spring/summer 2005

On 29 April 2005, the Commission published the Notice of Initiation of a safeguard investigation concerning imports of certain textile products originating in the People’s Republic of China.²² The information on imports collected by the Commission through the import monitoring system contained, in the view of the Commission, indications that imports of specific product categories may threaten to impede the orderly development of trade. In particular, imports of those product categories had clearly exceeded the indicative thresholds laid down in the Guidelines during the first quarter of 2005. This Notice of Initiation concerned imports of nine different product categories (4-7, 12, 15, 31, 115, 117) listed in the Annex²³ to the announcement.

The Commission had therefore decided to initiate an investigation to determine whether the application of textile specific safeguard measures in relation to those product categories is warranted. The Commission stated that it would reach its decision on the basis of the information available at the end of the investigation, and the decision had to be taken whether or not it would request formal consultations with China on the basis of Article 10a of Council Regulation (EEC) No. 3030/93. As it turned out, the investigation was completed rather swiftly and concluded that the imports of two product categories (4 and 115) could disrupt the market and thereby impede the orderly development of trade. In this respect, the Commission took advantage of the procedural steps and decisions provided by No. 5(e) of the Guidelines, which serve to expedite its procedures in cases of particular urgency.

On 27 May 2005, the Commission requested formal consultations with China for both categories of products – T-shirts (ex category 4) and flax or ramie yarn (category 115). In accordance with the TSSC, China was forced, purely from the receipt of the requests for consultations, to introduce self-restrictions in the exports. Pursuant to No. 5(d) of the Guidelines and No. 6 of the Notice of Initiation of a safeguard investigation, the determination and the reasons for the decision to request consultations were to be published in a notice in the Official Journal of the European Union. However, no such publication in the Official Journal appeared. The investigation into seven additional product categories, and also two categories covered by the expedited procedures, was initially carried forward. For other product categories with import growth close to the alert level, the Commission applied close surveillance.

Consultations were concluded on 10 June 2005 and led to the European Commission and Ministry of Commerce of the PRC signing a Memorandum of Understanding (MoU) on the export of certain Chinese textile and clothing products to the EU. The MoU covers ten import categories: 2 (cotton fabrics), 4 (T-shirts), 5 (pullovers), 6 (trousers), 7 (blouses), 20 (bed linen), 26 (dresses), 31 (brassieres), 39 (table and kitchen linen) and 115 (flax or ramie yarn). The EU and China agreed to restrict the growth of import levels for these products up to a value between 8% and 12.5%. In addition, the MoU stipulated a time limit for the measures of 31 December 2007. Only five of these ten product categories had been subject of the previous Notice of Initiation of a safeguard investigation. The EU granted China, as consideration for signing the MoU, the termination of its safeguard investigations for the product categories covered by the MoU, and agreed not to introduce any new measures under Paragraph 242 WPR for products not covered by the MoU.²⁴ Like the determination and the reasons for the decision to request consultations, the MoU has not been published in the Official Journal.

The MoU was transposed into Community legislation by Commission Regulation (EC) No. 1084/2005 of 8 July 2005²⁵ which amended Annexes II, III and V to Council Regulation (EEC) No. 3030/93 (having regard to Regulation (EEC) No. 3030/93 and in particular Article 19 thereof). Recital (6) in the preamble to the Regulation expressly refers to consultations with the PRC in the framework of Paragraph 242 of the WPR and Article 10a of Regulation (EEC) No. 3030/93, which had led to the conclusion of the MoU.

The Commission believed that the imports of Chinese origin of the affected categories, due to the existence or threat of market disruption, threatened to impede the orderly development of trade within the meaning of Paragraph 242 WPR and Article 10a of Regulation (EEC) No. 3030/93 for a number of reasons which are given in the recitals in the preamble to Regulation (EC) No. 1084/2005.

The proof of market disruption is essentially dependent on statistical data. During the course of the procedure, however, hardly any plausible import statistics could be presented. In some respects, the import data provided by EUROSTAT deviated considerably from that provided by the General Directorate Trade and TAXUD. At the beginning of 2006, six Member States were still unable to provide the required data.²⁶

Another core argument for a market disruption was the decline in import prices.²⁷ However, not taken into account at any time was the fact that the abolition of the quota costs alone,²⁸ which artificially

increased import prices prior to 2005, would automatically result in a price decline, which would have to be removed from the calculation to obtain an objective assessment.

IX. Compliance of the MoU of 10 June 2005 with Community legislation

Simply the fact that Paragraph 242 WPR (and thereby Article 10a of Regulation (EEC) No. 3030/93) cannot be challenged under WTO law, does not automatically lead to the conclusion that the implementation of the safeguard measures in question were in compliance with community legislation. Moreover, the EC has to obey its own standards which it created in transposing of Paragraph 242 WPR.

Due to the principle of limited powers specified in Article 5 of the EC Treaty, the EC needs a legal basis to conclude agreements with China on restricting the export of goods. Unlike Article 10(8) of Regulation (EEC) No. 3030/93, the specific provision in Article 10a of that Regulation does not contain any power to conclude such an agreement. However, Paragraph 242(b) WPR demands that every effort would be made to reach agreement on a mutually satisfactory solution. Based on the principle that Community legislation shall be interpreted this way, that it is in compliance with international obligations of the Community, the Commission was entitled to seek a settlement by way of consultation rather than just by unilateral measures. This result is also in compliance with the WTO principle of encouraging its Members to settle their differences by way of consultation.

a. Procedures and timetable for safeguard proceedings

First of all, the fact that only five of the total ten product categories covered by the MoU were subject to the safeguard investigation deserves attention. In the Notice of Initiation of a safeguard investigation,²⁹ any interested party may apply for an oral hearing by the Commission. The Commission promises to grant an oral hearing to any interested party who applies in writing within 21 days of the date of publication of the Notice in the Official Journal, showing that they are actually likely to be affected by the outcome of the investigation, and that there are special reasons for them to be heard orally. Importers of goods not covered by the safeguard investigation were barred from the option to present and prove any reasons for opposing the implementation of safeguard measures. Thus importers of bed linens (category 20) did not participate in the safeguard proceedings as this product category did not form part of the Notice of Initiation of a safeguard investigation dated 29 April 2005. Despite this, precisely this product category falls under the MoU as transposed into Community legislation by Commission Regulation (EC) No. 1084/2005 which introduces quantitative restrictions for the import of textiles.

The date on which the Notice of Initiation was published is also important because the quantitative limits imposed under this measure did not apply to products which had already been dispatched to the Community if they had been shipped from the supplier country of origin for export to the Community prior to the date of notification of the request for consultations.³⁰ The import restrictions based on the MoU did not draw a distinction between the product categories which had formed the subject of the request for consultations and those which had not. In addition, the decision to request consultations was not published in the Official Journal. Taking these facts into consideration, it is doubtful whether notification was made at all. Another point to consider is that the MoU was not published in the Official Journal either. The consequences of the MoU were only made public by Commission Regulation (EC) No. 1084/2005 which was published in the Official Journal on 9 July 2005.³¹ It is therefore unclear exactly when Article 10a(2) of the Council Regulation (EEC) No. 3030/93 was implemented.

The Community legislation is characterised by the principle of transparency which is laid down in Art. 1 EC Treaty. The Commission defined this principle in its TSSC Guidelines, stipulating that it attaches great importance to the transparency in the handling of its trade instruments, and that procedures

had to be conducted in a way that allowed all interested parties to be heard, properly motivated, and communicated to both the interested parties and the general public. The Commission also stressed that 'such transparency should result in greater predictability and certainty for trade and business, and ensure that decisions were taken in the best possible knowledge of all relevant factors and after having heard all relevant arguments'.³² In practice, however, the Commission did not publish its decision for requesting consultations or its reasons for doing so in the Official Journal. This leads to the conclusion that the Commission failed to apply its own self-defined standards for implementing the transparency principle. The option that the Commission may decide to expedite its procedures involving a shortening of the deadlines or a simplified and accelerated process does not bring any relief from these standards. The simple fact that decisions can be made faster does not mean that a publication of these decisions is not feasible. Decisions will not be decelerated only by publishing them properly.

Examining the commencement of proceedings also reveals several inconsistencies. According to Paragraph 1 of the MoU, the Commission was to terminate all ongoing investigations into products covered by the MoU. However, Article 10a No. 1(b) of the Regulation (EEC) No. 3030/93 states that 'consultations with China shall be continued during the term of the quantitative limit set up under this provision'. In the event, the consultations with China did not fail but were terminated once the parties had reached an understanding. This practice is in breach of Paragraph 242 WPR and Article 10a No. 1(b) of the Regulation (EEC) No. 3030/93. The reason for the given standard is that quantitative restrictions cannot remain in force indefinitely but are to be subjected to constant scrutiny by both parties as to whether they should continue to be applied. If the negotiating parties reach a voluntarily agreement on the basis of frank and friendly consultations to a conclusion *a fortiori*, this obligation must be obeyed, even if it is quite unclear which grade of voluntariness the Chinese delegation could enjoy.

b. Substantive legal aspects of the MoU

The MoU can be challenged on substantive as well as procedural grounds. Accordingly, the quantitative limits to be imposed must correspond to the levels of Chinese imports that existed when China received the Community's request for consultations.³³ Owing to the principle of proportionality, the MoU should not fall below these minimum quantities. It can be expected that China will accept a negotiated result which will be more favourable than the potential unilateral measures that the EU can impose based on Paragraph 242 WPR.

Consultations with China concentrated on two product categories which were the subject of the Notice of Initiation of the safeguard investigation dated 29 April 2005. The final MoU with its scope of 10 product categories, however, contained no less than 5 categories, for which the interested parties were excluded from presenting evidence that the invocation of the TSSC would have an important and tangible negative impact on their economic interest. Furthermore, three more product categories which formed part of the initial Notice of Initiation of a safeguard investigation, but did not fall under the expedited procedure, became the subject of quantitative import restrictions. In case of extreme urgency, consultations with China can be requested without an investigation having been instigated, or before investigations are completed.³⁴ Without good cause, the Commission deviated from its autonomous established standards regulating the conduct of investigations, and compromised the legal right of economic operators to trade in the relevant goods without carrying out a proper investigation.

The MoU provides for limiting the annual growth of imports of the relevant product categories covered by the understanding by between 8% and 12.5% during the period from 2005 to 2007. This means that the quantitative limit agreed was actually greater than the lower limit of 7.5% pursuant to Paragraph 242 WPR. However, the reference period used as a basis for the MoU and that for Paragraph 242 WPR were not identical. Whereas Paragraph 242 WPR takes into account the first 12 of the most recent 14 months preceding the date on which consultations with China were requested (that is, May 2005), the MoU refers to the period from March 2004 to February 2005 (categories 4 and 115), and April 2004 to

March 2005 (all other categories). It is not unproven that the different reference periods might create an erroneous basis for calculation causing a breach of Paragraph 242 WPR by agreeing on too low growth rates. Moreover, for five product categories, no formal request for consultations was made at all.

In addition, Paragraph 242(f) WPR (and thereby Article 10a No. 1(c) of Regulation (EEC) No. 3030/93) stipulates that no action taken under these provisions would remain in effect beyond one year. By contrast, the MoU has introduced quantitative restrictions for a period of more than 30 months.³⁵ It is true that Paragraph 242(f) WPR and Article 10a No. 1(c) of Regulation (EEC) No. 3030/93 allow the EC and China to extend this period by mutual agreement. However, this rule seems to open the door for extending the application of measures at the end of a 12-month period, rather than to extend it at the beginning of its application. Again, China and the interested parties are deprived of a proper procedure for questioning the need for ongoing import restrictions.

Commission Regulation (EC) No. 1084/2005 amended the Annexes to Council Regulation (EEC) No. 3030/93. Due to this amendment, imports into the Community of products which were shipped before 11 June 2005, but presented for free circulation on or after that date, were not to be subject to quantitative limits. Import authorisations for goods shipped between 11 June 2005 and 12 July 2005 were granted automatically, and could not be denied on the grounds that there were no quantities available within the 2005 quantitative limits. However, the imports of all products shipped from 11 June 2005 have been counted against the 2005 quantitative limits.³⁶ This effective date was kept unchanged in the later Commission Regulation (EC) No. 1478/2005.³⁷ Effectively, therefore, the race for import quotas had already commenced on 11 June 2005, a fact which was communicated in the Official Journal not earlier than 9 July 2005. This approach does not offer an acceptable degree of transparency and predictability to keep a reliable and sustainable basis for international trade and economic operators.

X. Conclusions

Despite the fact that the TSSC represents a flexible instrument for adopting safeguard measures on imports of textiles and clothing originating in China, the procedures applied to re-introduce quantitative restrictions leads to the impression that speed prevailed over legal compliance. Behind closed doors, grey-zone measures which have been abolished under WTO were concluded. Furthermore, the TSSC was not intended to be treated as *carte blanche* by the Community for imposing trade restrictions. The statistical data upon which its decision was based was anything but reliable. Rather elusive stays the fact that certain product categories were subject to quantitative restrictions without being subject to investigations beforehand and without the affected parties being properly involved in the decision-making process. In addition, the Community has ignored its own standards of transparency and predictability given by its members and transposed into precisely worded rules. The trust in the reliability of the Community's foreign trade rules was damaged considerably at the expense of the European consumers.

The phase-out of the TSSC at the end of this year does not automatically mean the end of textile quotas restricting specific categories of Chinese textile and clothing exports to the EU. Council Regulation (EC) No. 427/2003³⁸ transposed a product-specific safeguard mechanism which was agreed in Part I, No. 16 of the Protocol on the Accession of the People's Republic of China.³⁹ In cases where products of Chinese origin are being imported into the Community in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the Community industry, a safeguard measure may be imposed under this regulation.⁴⁰ Any measures taken under this Regulation may be applied until 11 December 2013.

Even after expiration of Council Regulation (EC) No. 427/2003, the EU can make use of the option to restrict imports of a product on the basis of Article XIX of the GATT temporarily if its domestic industry is injured, or threatened with injury caused by a surge in imports.

Keeping in mind the economic effects and the intransparent application of EU provisions, full liberalisation of the textiles and clothing trade can be the only way to find a fair balance between retailer, importer, producer and consumer interests after giving EU producers more transitional time to cope with the changes in world trade caused by China's accession to the WTO. It is to be hoped that lessons have been learned.

Endnotes

- 1 COM (2006) 763 final.
- 2 Compare the EU textile categories under <http://trade.ec.europa.eu/sigl/>. The US Textile and Apparel Category System is also available at <http://otexa.ita.doc.gov/corr.htm>.
- 3 Pietra Rivoli 2005, *The travels of a T-shirt in the global economy: an economist examines the markets, power, and politics of world trade*, Wiley & Sons, Hoboken, NJ, ISBN 0-471-64849-3.
- 4 Karlhans Sauernheimer 2004, 'Non-tariff barriers: analysis of effects on foreign trade', in J Zentes, D Morschett & H Schramm-Klein 2004, *Foreign trade: marketing strategies and management concepts*, Gabler.
- 5 Studies related to Quota Liberalisation:
 - 'Globalization in the apparel and textile industries: what is new and what is not?', Harvard Center for Textile and Apparel Research, Harvard University, December 2002.
 - 'The apparel and textiles industries after 2005: prospects and choices', Harvard Center for Textile and Apparel Research, Harvard University, December 2004.
 - HK Nordas 2004, 'The global textile and clothing industry post the ATC', WTO, Geneva.
 - Munir Ahmad 2004, 'Trade in textiles and clothing: some hard facts and the way forward', International Textiles and Clothing Bureau (ITCB), Geneva.
 - 'Study on the implications of the 2005 trade liberalisation in the textile and clothing sector', Institut Francais de la Mode (IFM) and Partners, 2004.
- 6 See 'The biggest German textiles retailers' (Annual Rankings) at: www.TWNetwork.de.
- 7 Document WT/MIN(01)/3 of 10 November 2001.
- 8 For more details on the TSSC refer to MT Bender 2005, 'Der Schild gegen den Drachen – zweiter Teil', *Recht der Internationalen Wirtschaft* (RIW), vol. 51, no. 6, pp. 416-421; Falke 2005, 'Unbeschränkte Einfuhr chinesischer Waren in die EU?', *AW-Prax*, pp. 150-151.
- 9 R Senti, GATT, pp. 236-237; Beise, Oppermann & Sander, *Grauzonen im Welthandel*, pp. 99-106; for the tariffication process, see Peter van den Bossche 2005, *The law and policy of the World Trade Organization: text, case and materials / Peter van den Bossche*, Cambridge University Press, New York, p. 447.
- 10 Beise, Oppermann & Sander, *Grauzonen im Welthandel*, p. 107; Petersmann, *Principle of non-discrimination*, pp. 113-115.
- 11 aka 'voluntary export restraints' (VER), see van den Bossche 2005, p. 449.
- 12 R Senti, GATT, pp. 427-428; Beise, Oppermann & Sander, *Grauzonen im Welthandel*, p. 132.
- 13 Beise, Oppermann, Sander, *Grauzonen im Welthandel*, p. 80.
- 14 Beise, Oppermann, Sander, *Grauzonen im Welthandel*, pp. 108-117.
- 15 Peter van den Bossche 2005, *The law and policy of the WTO*, p. 118.
- 16 Hilf in Hilf & Oeter, WTO-Recht, p. 159.
- 17 Hilf in Hilf & Oeter, WTO-Recht, p. 159.
- 18 MT Bender 2005, 'Der Schild gegen den Drachen', RIW, vol. 51, no. 6, p. 416.
- 19 OJ L 23, 28.1.2003, p. 1.
- 20 OJ L 275, 8.11.1993, p. 3. Regulation as last amended by Commission Regulation (EC) No. 139/2008 of 15 February 2008, OJ L 42, 16.2.2008, p. 11 by Commission Regulation (EC) No. 930/2005 (OJ L 162, 23.6.2005, p. 1).
- 21 OJ C 101, 27.4.2005, p. 2.
- 22 OJ C 104, 29.4.2005, p. 21.
- 23 See OJ C 104, 29.4.2005, p. 23.
- 24 Figure VI of the MoU.
- 25 OJ L 177, 9.7.2005, p. 19.

- 26 See, for instance, the statistic ‘China: real imports’ of the DG Trade, 23 March 2005, at: http://trade.ec.europa.eu/doclib/docs/2005/april/tradoc_122157.pdf.
- 27 See recitals (9) to (17) in the preamble to Regulation (EC) No. 1084/2005.
- 28 See III. above.
- 29 See No. 4.2 of the Notice, OJ C 104, 29.4.2005, p. 22.
- 30 Article 10a(2) Council Regulation (EEC) No. 3030/93 as amended by Council Regulation (EC) No. 1084/2005, OJ L 177, 9.7.2005, p. 19.
- 31 OJ L 177, 9.7.2005, p. 19.
- 32 See No. 5 Paragraph 1 of the Notice on the application of Article 10a of Council Regulation (EEC) No. 3030/93.
- 33 Paragraph 242(d) WPR and Article 10a No. 1(b) of the Regulation (EEC) No. 3030/93.
- 34 See No. 5(e) of the Guidelines.
- 35 11 June 2005 until 31 December 2007.
- 36 See Annex V(b), footnote (1) to Council Regulation (EEC) No. 3030/93 as amended by Council Regulation (EC) No. 1084/2005, OJ L 177, 9.7.2005, p. 19.
- 37 Commission Regulation (EC) No. 1478/2005 of 12 September 2005 amending Annexes V, VII and VIII to Council Regulation (EEC) No. 3030/93 on common rules for imports of certain textile products from third countries, OJ L 236, 13.9.2005, p. 3.
- 38 Council Regulation (EC) No. 427/2003 of 3 March 2003 on a transitional product-specific safeguard mechanism for imports originating in the People’s Republic of China and amending Regulation (EC) No. 519/94 on common rules for imports from certain third countries, OJ L 65, 8.3.2003, p. 1.
- 39 WT/L/432 dated 23.11.2001.
- 40 See Hilf & Bender, ‘Der Schild gegen den Drachen’, RIW 2004, pp. 65-69 and Falke 2005, *AW-Prax*, pp. 151-154 for details.

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