

Chinese wire garment hanger producers sent U.S. dry cleaners to the laundry

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ABSTRACT

Chinese wire garment hangers were sold to the United States at a price substantially lower than hangers from domestic firms. With only one domestic manufacturer remaining, the United States International Trade Commission (USITC) found evidence of material injury to the industry. Wire garment hanger imports from China were then subject to a tariff which brought a doubling of hanger prices while further eroding already thin profit margins of domestic dry cleaners.

An overview of the wire garment hanger market and the USITC action will provide essential facts to illustrate economic principles such as comparative advantage, economic welfare, costs of protectionism, industry consolidation, economies of scale, tariff revenue, industry structure, and the level of employment. This contemporary case is able to teach cognitive flexibility in a classroom setting while encouraging a discussion on the positive and normative aspects of international trade policy in a competitive global environment.

Keywords: Tariff, Protectionism, China, Hanger, Economics, Trade

INTRODUCTION

The journey of a wire garment hanger in the global economy is able to illustrate many principles of economic reasoning. When contemplating a hanger have you thought about: the manufacturing country of origin; the competitiveness of domestic relative to international wire garment hanger producers; a possible unfair trade practice among international sellers; how import duties on hangers affect pricing and employment; the impact on the dry cleaning industry; and how a non-flexible exchange rate regime affects cross-border merchandise trade?

Exploring these and other questions will begin with a background description of the wire garment hanger industry and the allegations of Chinese dumping into the United States. Next the paper will present the USITC investigation findings and determination of material injury to the industry. The subsequent tariff action had affects not only on domestic manufacturing and employment but also on dry cleaning business as well as consumers.

The consequences of the USITC action are predictable using economic principles. The paper elaborates on the economic implications of the tariff action and how the predictions of economic theory are consistent with the actual conditions in the marketplace. The paper concludes with a teaching note on how to use the facts of international wire garment hanger practices for pedagogical purposes to illustrate terminology, economic thinking, and encourage a discussion of the normative aspects of international trade.

RECENT BACKGROUND REGARDING CHINESE HANGER DUMPING

Lowly metal garment hangers have brought much attention to the domestic dry cleaning market and the USITC in the last seven years. Typically made from 16 SWG (standard weight gauge) metal, dry cleaners purchase approximately 3 billion of these SWG hangers per year. (Murphy, 2008) In 2006, the price of domestically-made hangers was around \$40 per thousand (\$0.04 per hanger) with Chinese made hangers costing roughly \$10 less (\$0.03 per hanger). (Murphy)

Allegations of Chinese metal garment hanger dumping into the United States have been occurring since mid-2000. Imports of Chinese metal garment hangers were able to capture 13 percent of all metal garment hanger sales in the United States in 2002, up from 2 percent in 1999. (Carnahan, 2003) Such a significant rise in market share was brought to the attention of the USITC in 2002. (USITC, 2003) On February 5, 2003, the USITC sought a remedy consisting of an additional duty on imports of SWG hangers from China for a three-year period. (USITC) However, on April 25, 2003, the President did not choose to impose the duties (USITC) and as a result Chinese imports and market share rose. (Chambliss, 2008) In 2007 the United States Department of Commerce reports Chinese wire garment hanger imports of \$68.5 million, a 52 percent gain over 2006 and an 800 percent increase over 2001. (Whitford, 2007) Analysts began to allege dumping in that these imports were selling "at 33.85 to 221.05 percent less than fair value." (Wells, 2008)

On March 19, 2008, the United States Department of Commerce along with the USITC notes in Table 1 the value and volume of wire garment hanger imports from China to the United States: (Department of Commerce, 2008)

Between January 2004 and June 2007 there were at least eight well known producers of SWG hangers in the United States: M & B Hangers, Ganchos N.V., Laidlaw Company LLC, Metro Supply Company, Nagel Manufacturing and Supply Company, Navisa Hanger

Manufacturing, Incorporated, Shanti Industries, and United Wire. (USITC, 2007) In 2007, M & B Hangers was the only remaining domestic manufacturer. (Wells, 2008)

The influx of Chinese hangers put significant pressure on domestic firms. Milton M. Magnus III, the third-generation CEO of M & B Hangers in Leeds, Alabama, states "We had one of our largest customers - Cintas Corp., which rents uniforms to American workers - just sign a contract to buy 100 percent of its hangers from China...I can't guarantee how long [American hanger production] will last." (Wells)

USITC INVESTIGATION AND DOMESTIC HANGER MANUFACTURING

M & B Hangers did not sit idly, but brought a petition before the USITC demanding redress for the Chinese dumping. (Wells) In accordance with Section 771(7)(F)(I) of the Act (19 U.S.C. § 1677(7)(F)(I)) the USITC was to consider factors such as: direct or indirect subsidies by country of origin, the use of excess manufacturing capacity or substantial production increases within the country of origin, the market penetration of the imports into the domestic industry, if import prices have a depressing effect on comparable domestic goods, the negative effects of the imports on the domestic industry, and if a trade restriction would simply shift import sources to other third-country markets.

The subsequent investigation found evidence of excess production capacity in China, a substantial increase in production and corresponding rise in sales to the United States, a benefit accruing to Chinese producers from capitalizing rather than expensing certain production outlays to reduce product pricing, the exclusion of some natural resource or utility costs resulting in an indirect public subsidy, that imports did have an adverse impact on the domestic industry, and insufficient evidence that imports from countries such as Canada, Mexico, or Vietnam would replace tariff bearing Chinese imports. Consequently, in accordance with United States statute, less than fair value sales and material injury to the domestic industry was present. (USITC, 2008)

The USITC states "On the basis of the record developed in the subject investigation, the United States International Trade Commission (Commission) determines, pursuant to section 733(a) of the Tariff Act of 1930 (19 U.S.C. § 1673b(a)) (the Act), that there is a reasonable indication that an industry in the United States is materially injured (USITC, 2008) by reason of imports from China of steel wire garment hangers, provided for in statistical reporting number 7326.20.0020 of the Harmonized Tariff Schedule of the United States, that are alleged to be sold in the United States at less than fair value." (USITC) The result of this report was the placement of a tariff of "ranging from a lightly starched 33 percent to a truly stiff 221 percent [an ad valorem rather than specific tariff]" (Stephenson, 2008), effective March 28, 2008. (Unknown Author, 2008)

With a protectionist tariff now in place, M & B Hanger was to hire 50 new employees with the potential of doubling the total number of employees in the next two years. (Stephenson) In Wisconsin, Shanti Industries was able to reopen with 20 workers and also promise a second shift. (Lank, 2008) Both firms together employ 564 individuals where the typical earnings are \$30,000 annually per worker. (Fuller, 2008)

EFFECTS ON DRY CLEANING FIRMS IN THE UNITED STATES

The flood of low price Chinese wire garment hangers had a positive impact on domestic dry cleaning businesses. Dry cleaners work on a relatively narrow profit margin, often eight to

ten percent of gross sales. (NCA, 2008) A slight improvement to this margin was brought about by declining hanger import prices, but margins began deteriorating again with the enactment of the tariff. According to National Cleaners Association, “within 24 hours of the announcement of the tariff decision, cleaners saw hanger prices jump 50 - 100% or more across the nation.” (NCA)

Other dry cleaning groups made similar claims: “Among the operators who are paying more for hangers, most are paying a lot more. Some 44 plus percent say they are soaking up price increases of 50 percent or more, while another 27 percent have seen prices jump 31 to 50 percent. “A box of 500 wire shirt hangers jumped from \$17.95 to \$41.60 [\$0.036 to \$0.083 per hanger].” (Murphy, 2008) On average, dry cleaners were spending \$4,000 more per year on wire garment hangers. (Fuller)

Domestic dry cleaners took this price hit to already thin margins just when the price of chemicals made from petroleum derivatives (Perchloroethylene and its Exxon-Mobil counterpart DF-2000) rose in response to high crude oil prices. (Waniek, 2007) Additional cost increases also corresponding to petroleum include transportation, energy, and the cost of the plastic garment bags, commensurately rose as well. (Jagger, 2008)

With over three billion new hangers in demand annually, hangers are a daily cost hit to the bottom line for dry cleaners. (USITC, 2008) Should dry cleaners accept thinner profit margins or try to pass along increases in cost by raising prices to customers? (Armentrout, 2008) The latter option began within one week of the tariff as retail pricing across the United States was inching higher. Dry cleaning prices for garments typically brought in by women were increasing more quickly than the type of clothing brought in by men. (Stock, 2008; Palmer, 2009)

An overall decline in dry cleaner revenues subsequent to the tariff and presumably a decline in employment or working hours per week is attributable to a rise in the costs of production due to the tariff and petroleum prices, the decline in demand due to an economic slowdown and less frequent use of dry cleaning services by consumers in response to higher prices.

DOMESTIC DRY CLEANING INDUSTRY

Increasing operating costs along with lean profit margins in any industry may bring about enterprise closures, particularly of the smaller firms, but also the expansion of more efficient industry giants. Such is the case for both points within the dry cleaning industry. In the domestic market dry cleaning businesses are going out of business at the fastest rate since the 1960s. (Wood, 2008) Also, two national firms, DRYCLEAN USA (Steiner, 2009) and Dry Cleaning Corporation (Editorial Staff, 2009), are increasing in size across the country through purchasing existing smaller firms or by franchising. Industry followers note that shrinking growth and lower margins will lead to a non-rosy future outlook. (USIR, 2008) All barometers point to declining revenues, falling profit margins and an exit from the industry of small sole proprietorships where approximately 30,000 firms compete. (Fuller)

ECONOMIC IMPLICATIONS

Economic terminology such as comparative advantage, monopolistic competition, oligopoly, and economies of scale are able to capture some of the characteristics that embody

both the manufacturing environment for wire garment hangers along with the retail market for dry cleaning services. Principles of economic reasoning may also predict the consequences of the USITC action prior to the implementation of the tariff. These predictions include affects on cost of goods sold, pricing, sales revenue, economic welfare, number of competitors, the influence of an inflexible undervalued exchange rate on import volume, and the social costs of protectionism. This contemporary example of a familiar product will nurture an understanding of economic terminology and theory while providing the context for a lively discussion on the dynamic international environment in which we find ourselves. Illustrating the following economic implications is possible with the preceding background summary.

Comparative Advantage

Chinese producers prior to the USITC action have a comparative international advantage in wire garment hanger production since they may sell hangers at a price lower than domestic manufacturers. In order to benefit from trade, consumers should buy in the least expense market and producers should sell in the dearest. Whether importing or exporting, the principle of comparative advantage suggests that trade across borders will result in net gain to economic welfare. The United States therefore benefits from importing Chinese hangers.

Market for Wire Garment Hangers

Wire garment hangers, like all markets, have both a supply and demand component. A tariff is a tax and one approach is to view taxes as a cost of production. The USITC tax will reduce supply (where supply embodies both domestic and international production) and result in a higher equilibrium price with a lower equilibrium quantity. Justifying the tax is a normative question, but the consequence of the tax on equilibrium price and quantity is predictable.

Economic Welfare

Another approach to analyzing the impact of the USITC tax on the domestic market is to assume that the international supply of wire garment hangers is perfectly elastic at the world price which is a price that is below the domestic equilibrium price of wire garment hangers. A lower world price will result in imports, gains in consumer welfare, losses in producer welfare, but a net gain in total welfare.

The tax on hanger imports results in the perfectly elastic world supply curve at the world price shifting up by the amount of the average tax per hanger. The world supply price plus the tax will still be lower than the domestic equilibrium hanger price. While the tariff does provide some protection to domestic hanger manufacturers, the tariff does not eliminate all imports. The result, domestic production will rise, domestic consumption will fall, imports will fall, and tariff revenue will increase. A net loss in economic welfare ensues since the rise in producer surplus along with the tariff revenue is less than the loss in consumer surplus along with the sum of the deadweight losses attributable to some consumers being driven out of the market due to a higher price along with some inefficient producers remaining in the market due to the protection. In the absence of a free market with open borders, economic welfare declines.

Tax incidence, that is who pays the tax, depends on the price elasticity of demand. Since the demand for wire garment hangers is an essential input to domestic dry cleaners, demand is more inelastic and as such cleaners are more likely to tolerate price increases given the limited number of substitutes (the price elasticity of demand is to likely range from 0.20 to 0.40). (USITC, 2008) For example, while folding garments is possible, the labor content of such an alternative is likely to exceed the increase in cost of the hanger due to the tariff aside from whether or not the consumer prefers folding. Dry cleaners may also try to moderate their hanger costs by encouraging customers to recycle hangers with discount incentives on services.

Elasticity of Demand

Domestic dry cleaners confront higher input costs as hanger prices rise in response to the tariff. The extent to which dry cleaners may pass along this increase in cost to customers depends upon the price elasticity of demand. Since the overall demand for dry cleaning services is discretionary, confronts competitors, and has alternatives, demand is more elastic. Any percentage increase in price will result in a greater percentage decrease in quantity demanded that in turn brings lower sales revenue. Consequently, domestic dry cleaners will absorb more than they pass along the cost increases and thereby contribute to lower profit margins.

However, the demand for dry cleaning services is not uniformly elastic. One difference in elasticity occurs with gender, the price elasticity of demand for garments needing dry cleaning by women, such as silk, is more inelastic since these garments are in need of professional cleaning. The result, the price to dry clean fabrics usually brought in by women rose by a greater percentage than other clothing articles.

Elasticity concepts also relate to income, that is, the income elasticity of demand. Dry cleaning services are a normal good where a rise in income will result in an increase in the quantity demanded of the services. Given the softening economic environment and the discretionary nature of the dry cleaning service demand, falling incomes result in a decline in quantity demand and therefore sales. The percentage decline in quantity is likely to be greater than the percentage by which income declines if the income elasticity of demand is income elastic. The dry cleaning industry will see sales decline more steeply than incomes in the economy overall, but will also recover more quickly as economic conditions improve. (Sellers, 2009)

Number of Sellers

The number of domestic manufacturing firms selling wire garment hangers predictably fell as Chinese hanger imports rose with the shift in comparative advantage to manufacturers abroad. The domestic manufacturing industry structure was oligopolistic with several producers prior to the USITC action, but is now duopolistic. The tariff covers nearly 20 Chinese exporters that remain in the industry and promote competition by reducing the interdependence of manufacturers. (USITC, 2008)

On the retail side, two factors have been working to increase consolidation. First, small inefficient dry cleaners have seen negative margins due to the confluence of international competition and the rise in production costs along with a recession in the United States. The result, larger drycleaners have bought several smaller competitors to secure the benefit of scale economies. Second, sales are down from previous levels and some higher-cost dry cleaners have

been exiting the market. These retailers operate in a monopolistically competitive environment where inefficient providers cannot escape the long-run trend toward zero economic profits. Additionally, lower sales would likely reduce domestic employment or working hours per week.

Exchange Rate

When identical products trade across international borders, economic theory suggests that the products should sell for the same amount when the price is given in the same currency. Purchasing power parity assumes flexible exchange rates along with the absence of tax differentials, trade restrictions or transportation costs. The RMB/USD exchanged rate is under control of the Chinese government and could rise by up to 40 percent against the dollar under a flexible exchange rate regime. (Cline & Williamson, 2009) Consequently, Chinese imports to the United States enjoy a pricing advantage in dollar terms. If the Chinese currency were to float against the dollar, a majority of the wire garment hanger pricing advantage could dissipate and when brought together with rising transportation costs due to escalating petroleum prices, the comparative advantage of Chinese firms could neutralize or even shift toward manufacturers in the United States.

Costs of Protectionism

How much does protectionism cost the consumer? In an industry with approximately 30,000 firms and each firm spending approximately \$4,000 more per year on average for wire hangers, a minimum of \$120 million in tariff revenue is likely. This estimate is a minimum since dry cleaner demand is not perfectly inelastic and as such part of the tariff will fall on manufacturers as well. Protecting 564 jobs with the tariff will amount to \$212,766 per job or 7.1 times the typical remuneration of \$30,000 annually per employee. Consumers are protecting hanger manufacturing jobs at a significant premium while the unseen opportunity cost is the foregone consumption spending on alternative items that would create sales, employment, and opportunities in other sectors.

TEACHING NOTE: SUGGESTIONS FOR CLASSROOM USE

The international competitiveness of the wire garment hanger industry and the USITC tariff action present an opportunity to teach and apply economic principles while encouraging classroom discussion on the normative aspects of these events.

Bring a few wire hangers to the classroom, pass them around and ask participants to suggest the competitive price of a hanger, the annual quantity of hangers bought in the United States, the hanger country of origin, the components contributing to the cost of bringing a hanger to market, and a profile of hanger purchasers. Convey to the participants that this simple product can help them not only understand economic principles but how international competition affects domestic consumers and producers along with job availability.

Next distribute the facts confronting domestic manufacturers and purchasers of wire garment hangers. The facts begin in the Recent Background Regarding Chinese Hanger Dumping section of the paper and continue through the Domestic Dry Cleaning Industry section. These sections provide an overview to derive the various ideas within the Economic Implications

section. After the students have had time to read through the facts, begin to ask questions that will draw out the notions of comparative advantage, equilibrium pricing, economic welfare, tax incidence, price and income elasticity of demand, manufacturing and retail competition, employment, exchange rate influence on pricing, and the costs of protectionism.

We find that as participants are able to comprehend the economic principles that embody the wire garment hanger environment, a lively discussion with more normative questions such as the following is possible:

- Is there a difference between free and fair trade, which perspective should characterize public policy?
- Does free trade make everyone better off as comparative advantage suggests?
- Who are the invisible beneficiaries and the visible losers in the wire garment hanger market, and why does this matter in lobbying efforts?
- How should the government use the tariff revenue?
- Does the tariff encourage or discourage domestic manufacturing firms to become internationally competitive?
- Are the consequences of the tariff action in line with expectations of policy makers, did the tariff have the desired effect, and if so, for how long?
- Is there an environmental benefit to the tariff?
- How kaleidoscopic is comparative advantage, can the economic environment change such that the tariff is inconsequential and China or other countries are again the most efficient international producers?
- What salient factors should lead to the determination of less than fair market value or material injury?
- Is the ability to adapt to changing market conditions a weakness or strength of a free market and who should bear the risks or rewards of operating in a free enterprise system – producers, consumers, investors, or the government?

You may want to conclude your discussion by polling participants on whether or not the imposition of the tariff and the loss in economic welfare is justifiable. You may also want to ask whether or not the participants had a change of opinion with the unfolding of the case discussion.

SUMMARY

The tariff was meant to protect American manufacturing jobs, but in doing so penalizes domestic dry cleaning firms and in the end consumers of wire garment hangers. Over the years, tariff use by the United States has been met with a variety of results, but the practice continues. (Lott, 2009) The March 2008 tariff action on wire garment hangers by the USITC represents this continuing practice as does the September 2009 tariff on tire imports from China with Chinese ire escalating more so with the later action due to the much larger dollar volume.

Wire garment hanger practices among Chinese producers illustrate how economic decisions are interdependent across borders. Essential economic principles can describe the consequences of the USITC action on economic welfare, the number of domestic manufactures, the impact on retail prices relative to the elasticity of demand, retailer profitability, industry consolidation, economies of scale, domestic manufacturing and employment, retail job

availability, tariff revenue, social costs of protectionism, and how a non-flexible exchange rate regime affects product pricing.

The duration of expanding domestic production, the continuing operation of inefficient factories resulting from tariff protection, and the extent to which the gain in manufacturing jobs will be offset by a decline in spending and employment within other sectors foregone by the collection of tariff revenue is still indeterminate.

Wire garment hangers present an easy to comprehend product that conveys the challenges of competing in a global environment. This contemporary case encourages cognitive flexibility by in-part fomenting a discussion on both the positive and normative aspects of international trade policy. Two domestic manufacturers remain in business; Chinese firms did not wash them completely out of the market. However, there are many ways to be taken to the cleaners and the levying of a tariff on wire garment hangers is yet another method.

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Table 1: Wire Garment Hanger Imports from China

| | 2005 | 2006 | 2007 |
|-----------------------------|-------------|-------------|-------------|
| China Value (USD million) | \$31.4 | \$45.2 | \$68.5 |
| Volume (billions of pieces) | 1.0 | 1.8 | 2.7 |

(USITC, 2008)

