

THE
CANADIAN
INTERNATIONAL
TRADE TRIBUNAL



CANADA

AN INQUIRY INTO TEXTILE TARIFFS

VOLUME 1: REPORT

February 1990

REFERENCE NO. MN-89-001

**AN INQUIRY
INTO
TEXTILE TARIFFS**

VOLUME 1: REPORT

Canadian International Trade Tribunal

The Canadian International Trade Tribunal is an independent quasi-judicial body which reports to Parliament through the Minister of Finance. It was established on December 31, 1988, by the *Canadian International Trade Tribunal Act*. The Tribunal hears appeals from rulings by Revenue Canada, Customs and Excise, on matters such as customs, excise and sales tax decisions. The Tribunal makes findings on whether or not imported goods which have been found to be dumped are injuring Canadian production of like goods. It also conducts import safeguard inquiries at the request of the government or domestic producers. Finally, the Tribunal acts almost as a standing commission of inquiry with powers to conduct research, hold public hearings and report on a broad range of matters relating to the economic, trade or commercial interests of Canada.

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FOREWORD

The inquiry into textile tariffs posed an exceptional challenge for the Canadian International Trade Tribunal in its first year of existence. We were pleased to take on this important and complex task.

The Minister of Finance asked us for advice on the Government's plan to reduce Canada's textile tariffs to levels more in line with those of other industrialized countries.

We have concluded that lower textile tariffs will benefit the clothing industry, other industrial users of textiles and consumers. The textile industry will face yet another adjustment challenge. We think, nonetheless, that firms in the industry will react to a gradual reduction in their tariff protection, as they have to other pressures, by becoming still more competitive and outward looking.

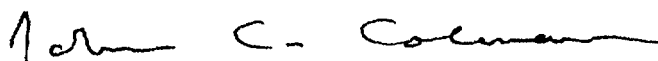
Our recommendations reflect the goal of easing the textile industry's adjustment to lower tariffs, while ensuring that the desired benefits of the Government's plan are realized. They also reflect our belief that a simpler textile tariff structure, more in tune with Canada's present circumstances, would best serve producers and consumers of textiles.

We want to thank the firms and industry associations that worked with us on the inquiry. Almost 500 firms in the textile, clothing and other downstream industries filled out questionnaires and provided us with their financial statements. In six weeks of public hearings, we heard testimony from over 80 firms. Industry associations such as the Canadian Textiles Institute and the Canadian Apparel Manufacturers Institute provided us with important submissions, as did many individual firms.

Members of these industries, working with us, gave us a feel for our subject that no amount of research and analysis could have matched. They also held up a mirror to themselves. We hope that what they have learned with us about their activities and competitive prospects will assist them in tackling the challenges they face in the 1990s.

Our staff have worked hard and well on behalf of both the Tribunal and interested parties. We would like to thank them for the long hours they devoted to this inquiry during the past year.

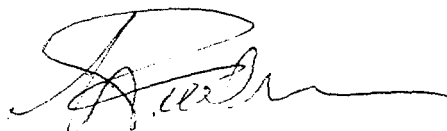
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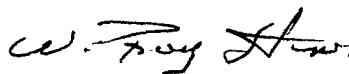
Member: Arthur B. Trudeau



Member: Sidney A. Fraleigh



Member: W. Roy Hines



1. Scope

These recommendations apply to the portions of the textile industry which produce fibres, yarns, fabrics and certain specialty products, and which generally serve as inputs in the manufacture of other products. Employment in this narrowly defined portion of the industry is approximately 33,000, compared to 61,000 in the entire industry as defined by Statistics Canada.

2. Tariff Rates and Structure

- (a) Canada's MFN textile tariffs should be reduced gradually to the following maximum levels:
 - fibres 5 percent
 - yarns 10 percent
 - fabrics, woven and knitted 16 percent
- (b) Current tariff rates for all specialty textiles should be reduced by one-third.
- (c) Any specific duties on textile products should be converted to their ad valorem equivalents and those rates should then be reduced, as required, to be consistent with the proposed rate structure.
- (d) All tariffs on fibres, yarns and fabrics whose rates are currently below the recommended maximum levels should not be changed.

3. Pace of Implementation

The target rates for each tariff item should be achieved by annual reductions of one percentage point. This will result in implementation schedules of up to four years for most fibres, up to three years for most yarns and up to nine years for most fabrics, including specialty textiles.

4. Start of Implementation

- (a) The reductions in textile tariff rates should be delayed until 1991 to allow the Government to get full credit for them in the current round of GATT negotiations scheduled for completion at the end of 1990.
- (b) If the completion of the negotiations is significantly delayed, the Government should still consider implementing these textile tariff reductions in 1991, but not "binding" them in the GATT until it has received adequate credit for them in the negotiations.

5. Exceptions

The tariff structure should apply without exception to all products produced by the textile industry as defined for the purposes of this inquiry. However, the simpler structure will leave untouched those items whose tariffs are already below the proposed maximum rates for fibres, yarns and fabrics. This amounts to some 117 of the total of 568 tariff items included in our definition of the textile industry.

6. Proposals for Tariff Elimination or Accelerated Reductions

In the course of its inquiry, the Tribunal received many representations for MFN tariff elimination or accelerated FTA tariff reductions on specific products. A list of these representations is contained in Volume 2 of this report. We recommend that the Government take early action on those representations which are noted as having received support from all interested parties and that it review the other items as soon as possible.

1. Introduction

(a) The Inquiry

In a letter dated February 6, 1989,¹ the Minister of Finance asked the Canadian International Trade Tribunal to give advice to the Government on how to reduce textile tariffs to levels which would be more in line with those of other industrialized countries.

The Tribunal undertook an ambitious year-long program of plant visits, public hearings and analysis involving the efforts of hundreds of industry participants and many representatives of industry associations, researchers and counsel. Tribunal members visited over 40 firms from Vancouver, British Columbia, to Bridgetown, Nova Scotia, in order to appreciate, first-hand, the production and distribution processes in the textile, clothing and other downstream industries. Almost 500 firms filled out questionnaires and submitted financial statements, providing a picture of these industries never before available. Hundreds of pages of research were generated by the Tribunal research staff and independent experts.

At three public hearings, lasting six weeks in all, more than 80 firms gave testimony. These hearings gave interested parties an opportunity to tell their story and to question one another on their different points of view. They gave Tribunal members a chance to ask questions, to make sure the facts compiled by our research staff were accurate and to get reactions to illustrative tariff reduction options before making final recommendations.

(b) Terms of Reference of the Inquiry

The main issue before us was not whether the Government's plan to reduce Canada's textile tariffs should go ahead, but how it should be implemented.

The terms of reference were controversial. Many in the textile industry considered that the whole project was misconceived. They argued that Canada should not unilaterally reduce its textile tariffs at a time when the industry was struggling to adjust to the Canada-United States Free Trade Agreement (FTA) and when textile tariffs and the future of the Multi-fibre Arrangement (MFA) were being discussed in the GATT Multilateral Trade Negotiations in Geneva. Since Canada's tariffs on all products were generally higher than those of other industrialized countries, why were textiles being singled out?

Textile industry representatives further argued that differences in nominal tariffs were less relevant than differences in the overall level of border protection. They suggested that Canada's overall protection of the textile industry was not excessive. They pointed to the shrinking of bilateral tariffs under the FTA, the concessionary items which make Canada's textile tariffs, measured on a duty-collected basis, lower than most-favoured-nation (MFN) rates, and, compared to the United States, Canada's less extensive system of MFA-sanctioned voluntary export restraints (VERs) on textile imports from "low-cost" sources.

1. The text of the letter is appended to the report in Annex A.

The textile industry argued that investment and production would shift to the United States if Canada allowed its overall level of border protection to fall below that of the United States. It doubted that clothing and other downstream manufacturers would pass on to consumers any cost savings from tariff reductions. In its view, the proposed tariff reductions would cause more harm to the textile industry than benefits to its customers.

The clothing and other downstream industries generally supported the terms of reference, although some viewed them as too little and too late. The clothing industry argued that there should be immediate and substantial reductions in textile tariffs. Tariffs should be removed on textile products not made in Canada. It recalled its disappointment with FTA provisions limiting duty-free access to the US market for garments made from third-country fabrics. Expectations of making large inroads into the US market on the basis of distinctive fabrics and fashions had been frustrated. Textile tariff reductions and elimination were necessary to help them remain competitive in the Canadian market.

The clothing industry, other downstream industries and retailers all agreed with the assumption in the terms of reference that textile tariff reductions would result in lower prices for consumers, given the competitive markets in which they operate.

2. Overview of the Textile and Downstream Industries (Chapters II and III of the Report)

The Minister's letter asked us to consider how tariff reductions would affect the textile and textile-using industries. We first had to define the industries and understand the connections among them, their competitive situation and major economic characteristics and challenges.

We decided to define the textile industry narrowly to include only the fibre, yarn and fabric components of the broader industry and a number of specialty textiles, such as felts and non-woven products. Our tariff recommendations would not apply, therefore, to products such as carpets, canvas, bed linen and other products considered by the Canadian Textiles Institute (CTI), Statistics Canada and others to form part of the textile industry. Producers of these goods would benefit from tariff reductions on fibres, yarns and fabrics. In 1988, roughly 33,000 people were employed in the textile industry as we have defined it. This compares to employment of 61,000 for the primary textile and textile product industries as defined by Statistics Canada.

Turning to textiles, we see an industry that has been performing well. It has adapted quite successfully to a series of trade, technological and market pressures. The industry has rationalized and restructured, concentrating on a more specialized product range, with a greater focus on textiles for industrial uses and export markets. The interdependence between the textile and clothing industries, although lessened, is still very strong.

The capital intensity of the textile industry is substantially higher than that of the clothing industry. In the past decade or so, the industry has invested heavily in upgrading machinery and equipment, in response to competitive pressures. The Government has assisted this investment through the Canadian Industrial Renewal Board (CIRB).

Labour-productivity advances in the textile industry outpaced those in the clothing and manufacturing sectors over the 1984-88 period. Employment reductions and increasing capacity utilization rates in the textile industry largely explain its better than average productivity performance.

The financial picture of the textile and textile-using firms was analyzed for the Tribunal by Clarkson Gordon. Its analysis showed that, on the basis of key financial indicators, the Canadian textile industry's performance between 1984 and 1988 exceeded the Canadian manufacturing average and that of the US textile industry. Clarkson Gordon also found the Canadian clothing industry to be highly profitable.

The value of imports accounted for 41 percent of the textile market in 1988, slightly more than the average for manufacturing industries as a whole, but substantially more than the 28 percent import market share for the clothing industry. The United States is the largest source of Canada's textile imports, accounting for one-half in 1988. Roughly 30 percent of textile imports into Canada originate in developing countries, compared to about 50 percent of textile imports into the United States. In recent years, developing countries have increased their share in Canada's textile imports more rapidly than their share of US textile imports, albeit from a much lower base. Approximately two-thirds of Canadian clothing imports are purchased from developing countries.

Textile and clothing imports into Canada face higher tariffs than most other goods. Many clothing and textile imports from developing countries are also restrained by VERs under the provisions of the GATT-sanctioned MFA.

SELECTED INDICATORS 1988			
	Textiles	Clothing	Total Manufacturing
Total Shipments (billions of dollars)	3.9	6.4	288.5
Import Share (FOB) of Apparent Market (%)	41	28	40
Export Share of Total Shipments (%)	17	7	38
Employment (thousands)	33	120	1,913
Return on Equity 1984-88 Average (%)	16.1	15.6	12.1
Sources: CITT survey, Statistics Canada and Clarkson Gordon.			

3. Tariff Comparisons (Chapters III and IV of the Report)

(a) Tariff Comparison Methods

In order to compare tariffs and establish tariff reduction targets, we had to address some key measurement issues:

- Which countries should form the basis for tariff comparisons?
- Should we take account of concessionary textile tariffs?

- What about tariff reductions under the FTA?
- Should we take into account non-tariff barriers such as VERs?

(i) Countries of Comparison

The Minister's letter directed us to make recommendations on reducing Canadian textile tariffs to levels comparable with those of our major industrialized trading partners. This suggested to us that the United States, the European Economic Community (EEC) and Japan should be the main focus of tariff comparisons, since together these countries account for 85 percent of Canadian imports. Accordingly, we could not accept the textile industry's suggestion that we take account of a number of smaller industrialized and newly industrializing countries which have relatively high textile tariffs. Because of the high proportion of Canada's trade accounted for by the United States, we agreed with the textile industry that the United States should receive the most weight in the tariff comparisons.

(ii) Concessionary Tariffs

Textile producers argued that average MFN rates overstate true tariff protection. Canada has many concessionary textile tariff items that eliminate or reduce actual duties paid on imported goods. On a duty-collected basis, average Canadian tariffs are lower than average MFN tariffs.

We decided not to use "average duties collected" for our tariff comparisons. Most concessionary provisions are not "bound" in the GATT. They usually pertain to goods not produced in Canada, and MFN rates could be re-imposed if there were prospects of Canadian production. Furthermore, the testimony of textile producers and users suggested that actual tariff rates, not some average based on duties collected, are more likely to influence prices, sourcing patterns and costs in the marketplace.

(iii) The FTA

The CTI argued that when FTA tariff reductions are fully implemented, Canada's average textile tariffs will be lower than those of other industrialized countries. This is because roughly one-half of Canada's textile imports come from the United States and these will be entering free of duty. If textile imports from all sources, including the United States, were used as weights in calculating average tariffs, Canadian tariffs would be about one-half the level suggested using average MFN (third-country) tariffs.

We considered that our terms of reference were clearly aimed at adjusting third-country tariffs as a complement to the FTA tariff reductions; therefore, we used third-country imports as weights for average Canadian and US tariffs. To do otherwise would imply that textile importers sourcing from Europe or the Pacific Rim face lower tariff costs than is actually the case.

(iv) Voluntary Export Restraints

Voluntary export restraints (VERs) on textile and clothing imports received considerable attention both at the hearings and in the research program, although no reference was made to them in the inquiry's terms of reference.

Despite extensive analysis, we were unable to arrive at a conclusive measure of the different protective effects of the Canadian and US VER regimes. We were influenced, nonetheless, by the arguments of the textile industry and by the research of our staff which indicated that quota coverage in the United States may be tighter and more comprehensive than in Canada.

(b) Main Findings of Tariff Comparisons

There are significant differences in the structure of textile tariffs between Canada, Japan, the EEC and the United States. EEC and Japanese tariffs are less dispersed and are differentiated to a far lesser degree among products than those of Canada or the United States. Although the US system is similar to that of Canada in its complexity, there are important differences in how Canada and the United States treat similar products.

The average MFN textile tariff¹ for Canada is 15.7 percent, compared to 10.5 percent for the United States. Canadian tariffs are significantly higher for specialty textiles, knitted fabrics and man-made fabrics. However, average Canadian tariffs on fibres and on woollen products are lower than those of the United States. Both Canadian and US average textile tariffs are considerably higher than those of the EEC and Japan, which average roughly 6 and 4 percent, respectively.

4. Tariff Reduction Options and Recommendations (Chapters V and VI of the Report)

At the October hearing, we explored two tariff reduction options: a proportionate reduction in tariffs and a simpler tariff structure that provided standard maximum rates for fibres, yarns and fabrics. We also examined various time periods for implementation. The options were tested with interested parties, and their reactions assisted us greatly in arriving at our final recommendations.

(a) Our Recommendations and Rationale

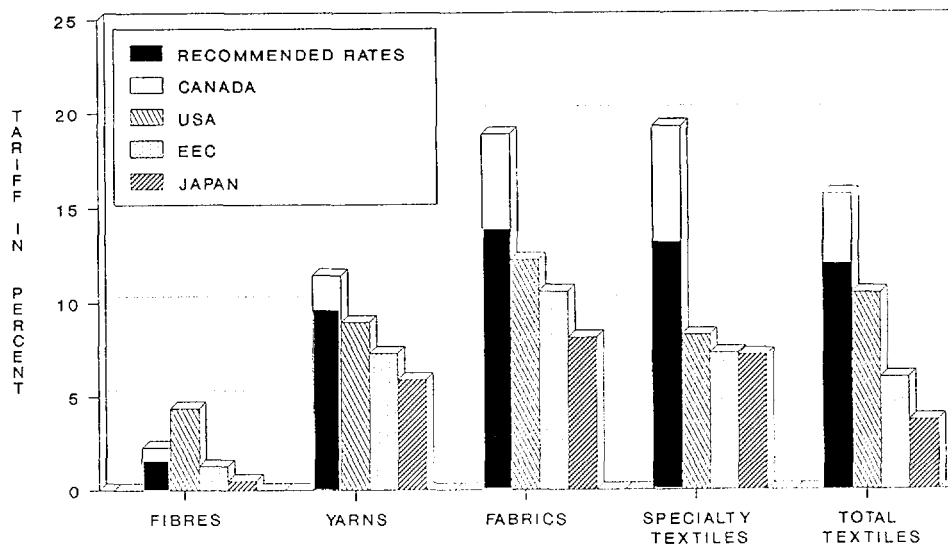
We recommend that Canadian textile tariffs be reduced by moving to a simpler rate structure of maximum rates of 5 percent for fibres, 10 percent for yarns and 16 percent for fabrics. Because specialty textiles are so varied and distinctive, their rates should be reduced by 33 percent, the same average reduction applied to man-made fabrics.

Implementing our tariff proposals will reduce Canadian textile tariffs by an average of 26 percent. Most product groups will still receive more tariff protection than their US counterparts and significantly more than in the EEC or Japan.

We rejected possible reduction schemes which would have eliminated completely the one-third gap between average textile tariffs in the United States and Canada or brought tariffs even lower towards the Japanese or EEC averages. We did so because of the FTA-related adjustments already facing the industry, the prospect of further textile tariff reductions in the MTN and because of the perception that the US VER regime provided more protection than was available in Canada under our VER system.

1. On a CIF evaluation basis. On an FOB basis, average Canadian and US textile tariffs are 16.6 percent and 11.1 percent, respectively.

**TRIBUNAL TARIFF RECOMMENDATIONS
AVERAGE MFN TARIFFS
CANADA, USA, EEC AND JAPAN**



Notes: Tariff schedules for Canada and USA adjusted from an FOB to a CIF basis.
Tariff schedules of Japan and the EEC.
Tribunal tariff recommendations adjusted from an FOB to a CIF basis.

There is much appeal in a less complicated tariff structure. The simpler tariff structure will avoid perpetuating the current tariff's uneven treatment of similar or substitutable products. Natural and man-made fabrics, for example, are often substitutable and yet tariffs on these goods can now differ by as much as 13 percentage points. Moving to a simpler structure "smooths the peaks" of our present system by bringing rates on similar products closer together. It also reduces the disparities in rates between Canada and the United States for products where our rates are particularly high. The simpler structure also avoids cutting for the sake of cutting. Of the 568 tariff rates affecting the textile industry as we have defined it, 117 would not be reduced.

Our recommendations also reflect the advice of interested parties that we should not import the US tariff system by adopting an approach that selected the lower of Canadian or US rates. The result of our recommendations is a "made in Canada" system that is more neutral among products and avoids imposing a structure not suitable for Canadian circumstances.

The new structure improves tariff relativity within textiles and between textile and downstream products. It delivers higher effective protection for the clothing and other textile-using industries.

(b) Pace of Implementation

After considering several options for tariff reductions, including annual proportionate cuts for all products spread over a fixed implementation period, we decided on an approach that would see a one-percentage point per year reduction

for all affected products. This will result in implementation schedules of up to four years for most fibres, up to three years for most yarns and up to nine years for most fabrics, including specialty textiles. We felt this was the fairest approach for two reasons. First, we believed that an annual reduction of one percentage point of tariff protection would affect all producers in roughly the same way, whether they be fibre manufacturers experiencing tariff cuts from around 8 percent down to 5 percent or fabric manufacturers facing reductions from 25 percent to 16 percent. The affected producers have different levels of tariff protection and will face quite different tariff reductions overall. However, the year-by-year adjustment burden should be similar for all products subject to cuts.

We also felt that it was important for those facing the largest tariff cuts, primarily man-made fabric producers, to have the longest time to adapt. This would not have been provided by a proportionate cut approach that phased in all tariff cuts over the same time period. Fibre and yarn producers will face tariff cuts of less than four percentage points, and these reductions will be completed well before those on many fabrics. Lower tariffs on their fibre and yarn inputs will help ease the adjustment of those fabric producers who face tariff reductions of up to nine percentage points.

(c) Date of Implementation and the MTN

Our terms of reference presumed that the tariff reductions would begin in April 1990. We heard strong arguments from the textile community that such an early commencement would pose many difficulties, in light of the fact that the FTA implementation is in its early stages, and the outcome of the negotiations under the Uruguay Round may not be known until early 1991.

We agree with the CTI that it would be preferable to delay implementation until the MTN have been completed, and the Government has made full use of the proposed reductions as bargaining levers in the negotiations. Accordingly, we recommend that the tariff changes be initiated in 1991, as soon as possible after the results of the MTN are known. This approach takes into account the relatively short time remaining before the scheduled completion of the Uruguay Round at the end of 1990.

If there were any significant delay in the completion of the MTN, the Government should still consider following through with the tariff reductions in 1991, provided it is satisfied that Canada will get adequate credit for them in the negotiations. Only when such credit is achieved should Canada offer to bind the tariff reduction schedule in the GATT. The textile tariff reductions need not await the full implementation of the general MTN results. To delay unduly the introduction of these tariff reductions would create uncertainties for producers and consumers of textiles.

(d) Exceptions

The basic philosophy underlying the simpler tariff structure is that exceptions should be few and far between. The simpler structure already has the advantage of sparing from large tariff reductions those sectors whose tariff protection is already below that of comparable products in Canada or the United States. Some of these sectors, such as cotton, are considered to be in a more sensitive position than the industry average and would be put on a more equal footing with the man-made sector as a result of the simpler tariff approach.

This did not prevent us from considering, as asked in our terms of reference, whether there were situations in which rates should remain high or reductions should be phased in over a longer time. In fact, we heard few calls for special treatment in terms of tariff rates. We paid careful attention to the testimony and our staff's research on individual sectors of the industry based on questionnaires and financial statements submitted by firms. We were not able to identify any individual products which should be exempted from the general tariff reduction approach. However, we did hear many arguments that the reductions should be delayed or phased in over a long time period. It was largely in response to these concerns that we recommended that tariff reductions be limited to one percentage point per year and that implementation of the tariff reduction program not begin until 1991.

(e) Proposals for Acceleration or Elimination

Our terms of reference asked us to consider whether any MFN tariffs on imports from third countries should be eliminated or whether any tariff reductions under the FTA should be accelerated.

We received many proposals of this nature. Most were opposed by the textile industry. Although a survey of those affected would undoubtedly reveal that some of the requests would not adversely affect the textile industry, we did not receive sufficient information from applicants and other interested parties to enable us to put forward recommendations on most of these items. Accordingly, we recommend that these requests be pursued further by government officials. For those few products for which sufficient information was provided and little industry opposition tendered, we recommend that concessionary tariff items be established. A list of these and other products that were the subject of proposals for tariff acceleration or elimination is contained in Volume 2 of the report.

We note also that many of the requests made to us for accelerated tariff cuts under the FTA were, at the same time, the subject of negotiations between Canada and the United States. A number of these requests formed part of the agreed list of products, released in November 1989, which will be subject to accelerated tariff reductions.

5. Implications of Recommendations (Chapter VII of the Report)

We believe that our recommendations fully address the various provisions of our terms of reference. Under the tariff proposals recommended here, textile tariffs will fall to levels more in line with, but still somewhat above, those in other industrialized countries. The recommended tariff structure will be simpler, less dispersed and more neutral in its treatment of similar products. It can be seen as a step towards a structure where rates for similar textile products are the same, an objective which could be pursued in the current MTN and future trade negotiations. Effective protection will increase for the clothing and other textile-using industries, putting these manufacturers in a better competitive position vis-à-vis imported products. This was a key objective underlying the terms of reference.

The terms of reference also asked that we examine the economic implications of our tariff recommendations. We found that the textile tariff reductions would generate overall benefits for the Canadian economy by reducing costs to textile-using industries and consumers. These benefits will greatly outweigh the

costs of somewhat lower output and employment for the textile industry. Because we have defined the textile industry very narrowly to include only fibre, yarn and fabric producers and a small number of specialty textile manufacturers, the tariff reductions will be confined to just over one-half of the textile industry as defined by Statistics Canada, the CTI and others. Other textile industries not subject to tariff reductions, such as carpet, bed linen and canvas producers, should actually benefit from tariff reductions to their textile inputs.

Our economic analysis confirmed what we had heard from many textile producers about the industry's competitive situation and capacity for change. Although important, tariff reductions represent only one of many factors with which the industry will be coping over the coming decade. We completed this inquiry with a feeling of confidence in the industry's ability to adjust successfully to our recommended tariff reductions and to the other challenges it faces.

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CHAPTER I

INTRODUCTION

1. Terms of Reference

The origins of the Tribunal's terms of reference for this inquiry were set out in a press release of the Minister of Finance dated March 22, 1988.¹ The release announced a three-part program of tariff relief designed to strengthen the competitive position of the Canadian textile and clothing industries in the domestic market. The program included:

- immediate tariff reductions on some specialty fabrics;
- new duty remission programs; and
- a plan to reduce textile tariffs in the future to levels comparable with those in other industrialized countries.

The immediate tariff reductions concerned 13 fabrics and yarns not made in Canada and involved both reductions on tariffs from all countries and the elimination of tariffs on imports from the United States. The new duty remission programs were introduced for denim fabrics imported by both textile and clothing manufacturers; certain greige fabrics, for finishing and use in clothing; outerwear imported by clothing manufacturers; outerwear fabrics imported by textile manufacturers; and girls' and ladies' blouses and shirts imported by clothing manufacturers.

Before going ahead with his plan to reduce tariffs on textiles to levels comparable with those of other industrialized countries, the Minister announced that he would ask the Canadian International Trade Tribunal to advise him on:

- the level to which textile tariffs should be reduced; and
- the pace at which the reductions should take place.

Under section 19 of the *Canadian International Trade Tribunal Act*, the Minister of Finance can direct the Tribunal to inquire into tariff-related matters. On February 6, 1989, he sent a letter² to the Chairman of the Tribunal which included the following major terms of reference directing the Tribunal to:

- " - assess the economic impact of bringing Canada's textile tariffs down to levels comparable with those of our major industrialized trading partners;
- make recommendations on the level and pace of tariff reductions that will maximize the economic gains to Canada without causing undue hardship to domestic suppliers of textile products and, in this latter regard, indicate whether there are specific textiles on which the tariff should not be reduced;
- make specific recommendations on the ultimate level to which textile tariffs should be reduced over the next ten years, bearing in mind Canada's objectives in the Uruguay Round of Multilateral Trade Negotiations (MTN) currently underway;

1. The full text of the press release is reproduced in Volume 2.

2. The full text of the Minister's letter is appended to this report in Annex A.

- make recommendations on what should be the pace of the tariff reductions and, specifically, whether the tariffs on some fabrics and yarns could be reduced at an accelerated pace without causing injury to textile producers;
- make recommendations on the scope for accelerated bilateral reductions of textile tariffs under the Free Trade Agreement with the United States;
- assess and make recommendations on the level of relativity that should exist in the tariff protection at the various levels of the manufacturing chain (i.e., from fibres and yarns through fabric to finished product)."

2. Organization of the Inquiry

The inquiry took just over a year to complete. It had many facets and many players. The main participants were firms in the textile, clothing and other downstream industries and in the distribution sector. Representatives of these firms made submissions and appeared as witnesses. The full lists of witnesses and counsel can be found in Volume 2. Through submissions and active participation in the public hearings, the CTI, Dominion Textile Inc. (Domtex) and the Canadian Apparel Manufacturers Institute (CAMI) played leading roles.

In organizing the inquiry, we decided to choose a process which would facilitate input from interested parties and would be transparent.

To establish the facts, we had our staff survey the industry. Close to 500 firms, including textile manufacturers, clothing and other downstream manufacturers, importers and distributors, responded to our questionnaires and submitted financial statements. For the textile industry itself, over 80 firms accounting for over three quarters of the industry's output participated in our survey.

An essential part in understanding the industries and their markets was seeing how the manufacture and distribution of textile and downstream products take place. In April and May 1989, we visited over 40 manufacturing and distribution firms in Nova Scotia, Quebec, Ontario, Manitoba, Alberta and British Columbia.

It was at the public hearings, however, that we were able to test the research produced by our staff and obtain the views of industry on how business is done. We decided to hold a preliminary public hearing to explain how we intended to conduct the inquiry and to give parties the opportunity to comment on our terms of reference and on the research plan of the Tribunal's research staff. This was followed by two lengthy public hearings, one starting in June and the other, in October.

The primary objective of the June hearing was to establish the facts concerning the textile and downstream industries and their markets. We had our research staff prepare a series of background papers for the June hearing dealing with the industry, tariff issues, the international setting and the methods of economic analysis that were to be used. These papers provided the framework and direction for the research program.

Most of the June hearing was, however, devoted to hearing testimony from players in the business. In the course of four weeks, we heard over 80 witnesses. They represented large and small firms in the textile and related industries from across the country. They answered our questions and explained to us how their businesses were run and how they would be affected by reductions in textile tariffs. With this testimony and the staff research work, we achieved a better understanding of the industry and we gathered many of the facts needed to develop our recommendations.

The primary purpose of the two-week October hearing was to give parties the opportunity to review, comment on and question the research prepared by the Tribunal's staff and consultants. A full list of the papers produced can be found in Volume 2 of our report. We thought it essential that this analysis and research be tested in a public hearing, which would permit questions and cross-examination of both our own staff and consultants.

In October, parties focused in particular on the research staff analysis of the responses to the questionnaires received from the textile and downstream industries, on illustrative tariff reduction options and on international issues, such as the MFA, VERs and the MTN. They also questioned consultants on their work for the Tribunal, including Clarkson Gordon (Financial Situation in the Industry), Informetrica Limited (Economic Effects of Tariff Reductions) and Abt Associates of Canada (Benefits and Costs of Tariff Reductions).¹ The October hearing was particularly useful because of what parties told us about the illustrative tariff reduction options put forward by our research staff.

3. Organization of the Report

Our report is divided into seven chapters, including this introductory chapter. In Chapter II, we review the structure, performance, competitive factors and future directions of the textile and downstream industries. Chapter III deals with the international setting, concentrating on factors such as the MFA, VERs and the MTN.

The last four chapters deal with tariffs. In Chapter IV, we analyze the tariff structures of Canada, the EEC, Japan and the United States and we discuss the conceptual questions we faced in comparing tariffs. The final section of this chapter shows actual tariff comparisons focusing in particular on differences in tariffs between Canada and the United States.

Chapter V describes the illustrative tariff options which were developed by the Tribunal staff and which parties considered at the October hearing. The chapter also reviews the October hearing discussions of the probable economic effects of implementing those options.

Chapter VI sets out our tariff recommendations and the rationale underlying them. This chapter also deals with the numerous specific proposals received by the Tribunal for the elimination of MFN tariffs or acceleration of FTA reductions.

The implications of our proposals for the structure of tariffs and changes in effective protection are described in Chapter VII. This chapter also includes an assessment of the economic effects of our recommendations.

Annex A of this report contains the full text of the Minister's letter of reference and Annex B, a list of Tribunal staff who worked on the inquiry.

Our line-by-line tariff recommendations are contained in a separate volume, Detailed Recommendations and Background Papers. This Volume 2 also includes lists of specific proposals by parties for acceleration or elimination of tariffs and additional statistical material, further discussion of technical issues, documents on the organization of the inquiry and a summary of the research program.

1. A list of the eight consultants commissioned by the Tribunal, as well as synopses of their reports for the inquiry, can be found in Volume 2.

CHAPTER II

THE TEXTILE AND DOWNSTREAM INDUSTRIES

1. Introduction

The performance of, and the prospects for, the Canadian textile and downstream industries are issues at the heart of the Tribunal's tariff inquiry. The inquiry arose from concerns about the competitiveness of clothing and other industries using textiles in their operations. In his letter of reference, the Minister of Finance observed that, "since these [textile] input materials constitute a significant portion of the overall cost of manufacturing finished products, the effect of this [high textile tariffs] policy has been to increase costs for the apparel industry, for many other downstream industries which use textiles in their operations, and for consumers." In comparing the level of effective tariff protection for textile and downstream industries, the Minister further observed that "This tariff structure has placed downstream industries at a competitive disadvantage in the Canadian market against imports of the finished products."

The Minister also suggested that the enhanced competitiveness of the downstream industries had to be weighed against the effect of the tariff reductions on the textile industry. A judicious approach to tariff reduction was needed. In his letter of reference, therefore, the Minister affirmed that "Tariff reductions would have to be implemented in a manner that takes into account the importance of the domestic textile industry to the Canadian economy. They should be consistent with the textile industry's ongoing efforts, through heavy investment and rationalization of production, to enhance the viability of its operations and to adjust to the international trading environment. They should also take into account the significant role the industry plays in the economic well-being of many small communities in Canada."

Because of the importance of these issues to our overall recommendations, the Tribunal has devoted considerable time in understanding the performance of, and prospects for, the textile and downstream industries. Our familiarization with these issues began with visits to firms during the spring of 1989. These visits took us across the country, from Nova Scotia to British Columbia. We talked informally with many leaders in the textile, clothing, furniture and retailing industries about their operations and their products. Our inquiry continued through the four weeks of public hearings in June 1989. During those hearings, industry representatives, from the full spectrum of textile and textile-related industries, appeared before us to offer their views and answer our questions on how textile tariff reduction proposals would affect the competitiveness of their industries.

Additional evidence on industry performance was put before us during the October hearing. Clarkson Gordon reported on its analysis of company financial statements. Werner International and the Tribunal staff presented sector profiles resulting from surveys of the textile and downstream industries. Our staff's research findings on the competitiveness of the textile and downstream industries were measured against the performance of those same industries as reported in Statistics Canada data.

This multifaceted approach gave the Tribunal a unique and invaluable perspective on the performance of the textile and downstream industries and their prospects as they enter the 1990s. This perspective helped us to formulate our assessment on two key issues: the potential benefits of textile tariff reductions to downstream industries in Canada and the ability of the textile industry to respond to increased competitive pressure brought about by those tariff reductions.

This chapter sets out our understanding of the competitiveness of the textile and downstream industries. But before embarking on this discussion, we outline briefly Canada's textile policy during the 1970s and 1980s and the relative importance of textile and textile-related manufacturing in the economy.

2. The Policy Environment

The Canadian government has paid special attention to the textile and clothing industries. A series of policies have provided border protection and restructuring assistance enabling the textile and clothing industries to compete more effectively in Canada and abroad. The industries have been protected by high tariffs, in comparison to tariffs on most other manufactured goods, and VERs under the MFA, which governs international trade in textiles and clothing.

The National Textile Policy of 1970 addressed problems arising from increased "low-cost" imports of textiles and textile products, such as clothing and consumer textile items. The Textile and Clothing Board was established as part of this policy to conduct inquiries into situations involving possible injury to Canadian companies and workers arising from import penetration and to formulate recommendations for special measures of protection. The Textile and Clothing Board's recommendations for special protection were to be based on evidence that the affected domestic producers had prospects of continued viability and competitiveness in the Canadian market.

The 1981 National Textile Policy had as one of its main features the creation of CIRB which was charged with, among other things, the task of assisting the textile and clothing industries to restructure and modernize so that they could compete more effectively with imports. CIRB authorized grants, between 1981 and 1986, of approximately \$140 million and \$100 million to assist the restructuring and modernization of the textile and clothing industries, respectively. To qualify for assistance, firms were required to evaluate their marketing strategies, operations and organizational structures. For many firms, the combination of government assistance and internal evaluation led to improved competitiveness.

In 1986, on the occasion of the fourth MFA renewal, the Government announced a new textile policy. The Government reaffirmed its commitment of maintaining a viable level of textile and clothing production in Canada and of ensuring that these industries had a more stable and secure environment in which to plan their future. This was to be accomplished through the international negotiation of a more effective import restraint regime which would provide, among other things, for a substantial moderation in the import growth rate and a better control over import surges in the wake of the high growth in "low-cost" clothing imports in 1983 and 1984.¹ These negotiations appear to have resulted in tighter restraints for clothing imports in particular.

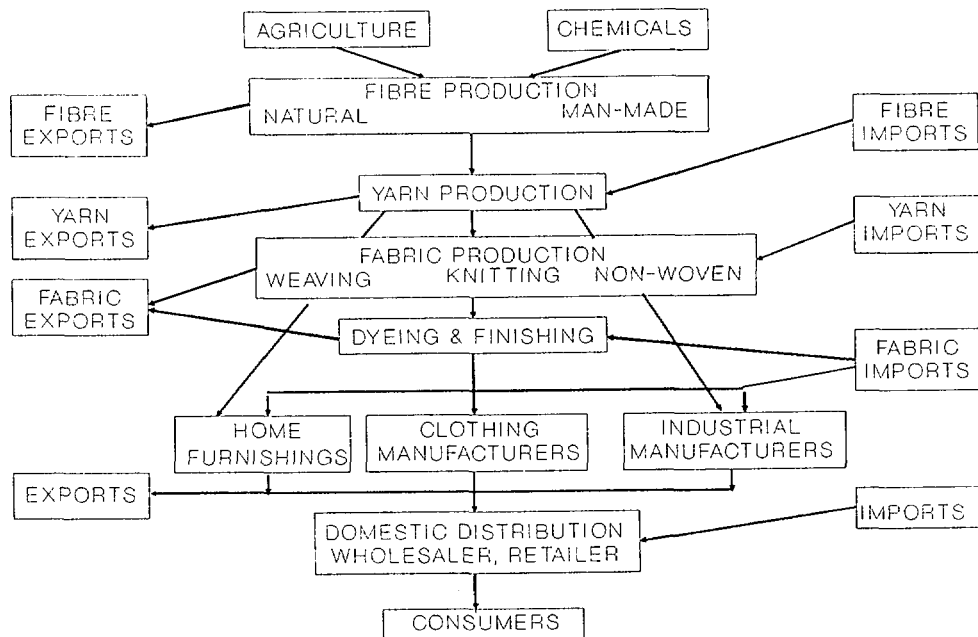
3. Textiles in the Canadian Economy

Textile-based manufacturing comprises a large number of interrelated industries. From the initial fibre stage, the output at each phase of production becomes a primary input component for the next production stage. As can be observed in Figure 2.1, textile manufacturing involves several processes, each with its particular inputs and outputs.

1. Summary of Canada's Bilateral Restraint Arrangements -- Textiles and Clothing. Department of External Affairs, October 1987.

Figure 2.1

THE TEXTILE AND RELATED INDUSTRIES



Source: Adapted from Canadian Textiles Industries, Human Resources Study, Immigration Canada, November 1988.

One focus of the Tribunal's inquiry into textile tariffs has been the supply links between the textile industry and its major downstream industries: clothing, home furnishings and industrial goods. Of these, the principal downstream industry is clothing. The Canadian clothing industry purchases about 40 percent of the total output of the Canadian textile industry. The historically close relationship with the clothing industry remains a fundamental basis for profitable textile manufacturing in Canada.

In 1988, the textile and downstream industries accounted for 5.7 percent of the gross domestic product for the manufacturing sector and under 1.0 percent of the gross domestic product for the total economy. They employed approximately 193,000 people or about 10.0 percent of manufacturing employment. The industries invested about \$350 million, representing 2.0 percent of new investment for total manufacturing. Their combined exports were about \$1.4 billion, representing 1.3 percent of exports of all manufactured commodities. Imports were about \$5.2 billion or 4.3 percent of total imports of all manufactured goods. (See Table 2.1)

4. The Textile Industry

(a) Definition

The letter of reference directs the Tribunal to provide advice on the Government's plan to reduce tariffs on textile fibres, yarns and fabrics to levels comparable with those in other

<p style="text-align: center;">Table 2.1</p> <p style="text-align: center;">PRINCIPAL INDICATORS TEXTILE AND DOWNSTREAM INDUSTRIES 1988</p>				
	Textile and Downstream Industries ⁽¹⁾	% of Mfg.	Total Manufac- turing	Total Economy (Goods & Services)
Gross Domestic Product (billions of dollars)	5.6	5.7	99.1	601.5
Employment (millions)	0.19	10.0	1.9	12.2
Imports (billions of dollars)	5.2	4.3	119.8	153.4
Exports (billions of dollars)	1.4	1.3	109.5	157.3
New Investment (billions of dollars)	0.35	2.0	17.6	123.2
<p>Note: (1) Include primary textiles, textile products, clothing, upholstered furniture and mattresses.</p> <p>Sources: Statistics Canada Catalogues 11-010, 15-001, 61-214, 71-001, 71-529. Industry, Science and Technology Canada (ISTC), <u>Commodity Trade by Industrial Sector, 1984-88</u>.</p>				

industrialized countries. We have interpreted the reference to apply to those products generally associated with the extrusion, spinning, weaving and knitting of man-made and natural fibres by the textile industry and also certain specialty textiles. A complete listing of affected products and tariff items is included in Volume 2 of this report.

Corresponding to these products and tariff items are the relevant industry components of the Canadian textile industry. Table 2.2 identifies the components of the textile industry for the purposes of this inquiry, describing them in terms of Standard Industrial Classification (1980 SIC) categories. Included are the four component groups of the SIC primary textile industry: the man-made fibre and filament yarn industry, the wool yarn and woven cloth industry, the other spun yarn and woven cloth industries, and the broad knitted fabric industry. As well, the specialty fibre, yarn and fabric components of the SIC textile products industry are included (i.e., the natural fibres processing and felt products industry, the narrow fabric industry, the tire cord fabric industry and the thread component of the "other textile products" industries). And finally, the coated fabric component of the floor tile, linoleum and coated fabric industries is included in this definition of the textile industry.

The proposed tariff reductions will directly affect only the tariffs of the fibre, yarn, fabric and specialty components of the textile industry, as defined above. The tariff cuts have not been considered for textile products such as carpets, canvas, household and hygiene products. These textile products are not fibres, yarns or fabrics. Nor are they, for the most part, intermediate products for further processing. They are typically final-use products. This is an important point of emphasis since, in the analysis of the performance of the textile industry which follows immediately, it is the portion of the industry that would be affected by the tariff cuts that is analyzed, not a more broadly defined industry as, for example, is represented by the CTI.

(b) The Industry and its Market

Most establishments in the textile industry are relatively capital-intensive. Many leading textile firms are multinational companies. Most sectors of the Canadian textile industry are dominated by a small number of large firms. The notable exception is the

Table 2.2	
DEFINITION OF THE TEXTILE INDUSTRY FOR PURPOSES OF THE PROPOSED TARIFF REDUCTIONS	
Industries Included In Proposed Tariff Reductions*	SIC Industry ⁽¹⁾
<ul style="list-style-type: none"> * Man-made Fibre and Filament Yarn Industry * Wool Yarn and Woven Cloth Industry * Other Spun Yarn and Woven Cloth Industries * Broad Knitted Fabric Industry 	Primary Textiles
<ul style="list-style-type: none"> * Natural Fibres Processing and Felt Products Industry * Narrow Fabric Industry * Tire Cord Fabric Industry * Thread Component of Other Textile Products Industries 	Textile Products
Carpet, Mat and Rug Industry ⁽²⁾ Canvas and Related Products Industry ⁽²⁾ Household Products of Textile Materials Industry ⁽²⁾ Hygiene Products of Textile Materials Industry ⁽²⁾ Contract Textile Dyeing and Finishing Industry ⁽²⁾ Other Textile Products Industries ⁽²⁾	
* Coated Fabric Component of the Floor Tile, Linoleum and Coated Fabric Industry	Other
Notes: (1) SIC = Standard Industrial Classification. (2) Carpets, canvas, household, hygiene, contract textile finishing and other textile products are considered as textile downstream industries in this inquiry.	

broad knitted fabric sector which is characterized by a comparatively large number of producers.

The textile industry, as defined for the purposes of this inquiry, employed about 33,000¹ people in the manufacturing of fibres, yarns, fabrics and specialty textiles in 1988. About 90 percent of the employment was in the provinces of Ontario and Quebec, with the bulk of textile production taking place in smaller urban communities. For the sample of firms that responded to the CITT questionnaire of textile manufacturers, over 85 percent of the reported employment in 1988 was in communities of less than 100,000 people.

The apparent Canadian market for textiles was approximately \$5.5 billion in 1988. The market grew throughout the period, but growth slowed in 1988. Total shipments by domestic firms (shipments for both domestic and export markets) grew to about \$3.9 billion in 1988. Growth slowed in 1988, but exceeded that of the apparent market. Total shipments were buoyed by the continued high growth in exports. Domestic shipments grew less rapidly than imports, which captured an additional percentage point of the market. This compares to all manufacturing in Canada which lost four percentage points of the apparent market to imports over the same period. Notwithstanding this performance, the level of import penetration remains higher for textiles than for all manufacturing.² (See Table 2.3)

1. The primary textile industry employed approximately 28,000 people in 1988. The broad textile industry, defined to include both the primary textile industry and the textile products industry, employed approximately 61,000 people in 1988. These numbers, as well as those for clothing, other downstream industries and total manufacturing, were estimated on the basis of 1986 reported employment projected forward on the basis of the growth in Statistics Canada's Labour Force Survey employment estimates. See Volume 2 for further explanation of the estimation procedure.

2. In 1988, domestic shipments met 59 percent of the apparent Canadian market for textiles, as defined for purposes of this inquiry, when imports are valued on an FOB basis. This compares to 60 percent for all manufacturing. When imports are measured on a CIF plus duty paid basis, the domestic textile industry met 55 percent of the apparent Canadian market compared to 59 percent for all manufacturing in 1988 (CITT staff estimates). For a discussion of the "level of trade" measurement issue, see Volume 2.

<p style="text-align: center;">Table 2.3 APPARENT CANADIAN MARKET FOR TEXTILES* 1984-88 (Millions of Dollars)</p>					
	1984	1985	1986	1987	1988
Total Shipments	3,180	3,149	3,456	3,777	3,885
Exports	382	395	462	545	657
Domestic Shipments	2,798	2,754	2,994	3,232	3,228
Imports (FOB)	1,879	2,004	2,125	2,262	2,289
Apparent Market	4,677	4,758	5,119	5,494	5,517
Domestic Shipments of Apparent Market (%)					
Textiles	60	58	58	59	59
Manufacturing**	64	63	61	62	60
<p>Notes: * Textile industry as defined for the purposes of the proposed tariff reductions. See Volume 2 for explanation of the estimation procedure. ** See Volume 2 for the apparent Canadian market table for all manufacturing.</p> <p>Sources: Trade Analysis Paper, CITT survey, ISTC and Statistics Canada.</p>					

A longer term perspective on the industry is given in Figure 2.2. Since 1961, the primary textile industry¹ has accounted for a falling share of overall manufacturing domestic output and apparent market. Throughout this same period, the primary textile industry has faced somewhat more import competition and exported less of its total production than all manufacturing.

(c) Textile Industry Issues

As pointed out in the introduction to this chapter, the performance of, and prospects for, the Canadian textile industry were central themes in this inquiry. In this section of the report, we identify some views on these issues expressed to us by the Canadian industry.

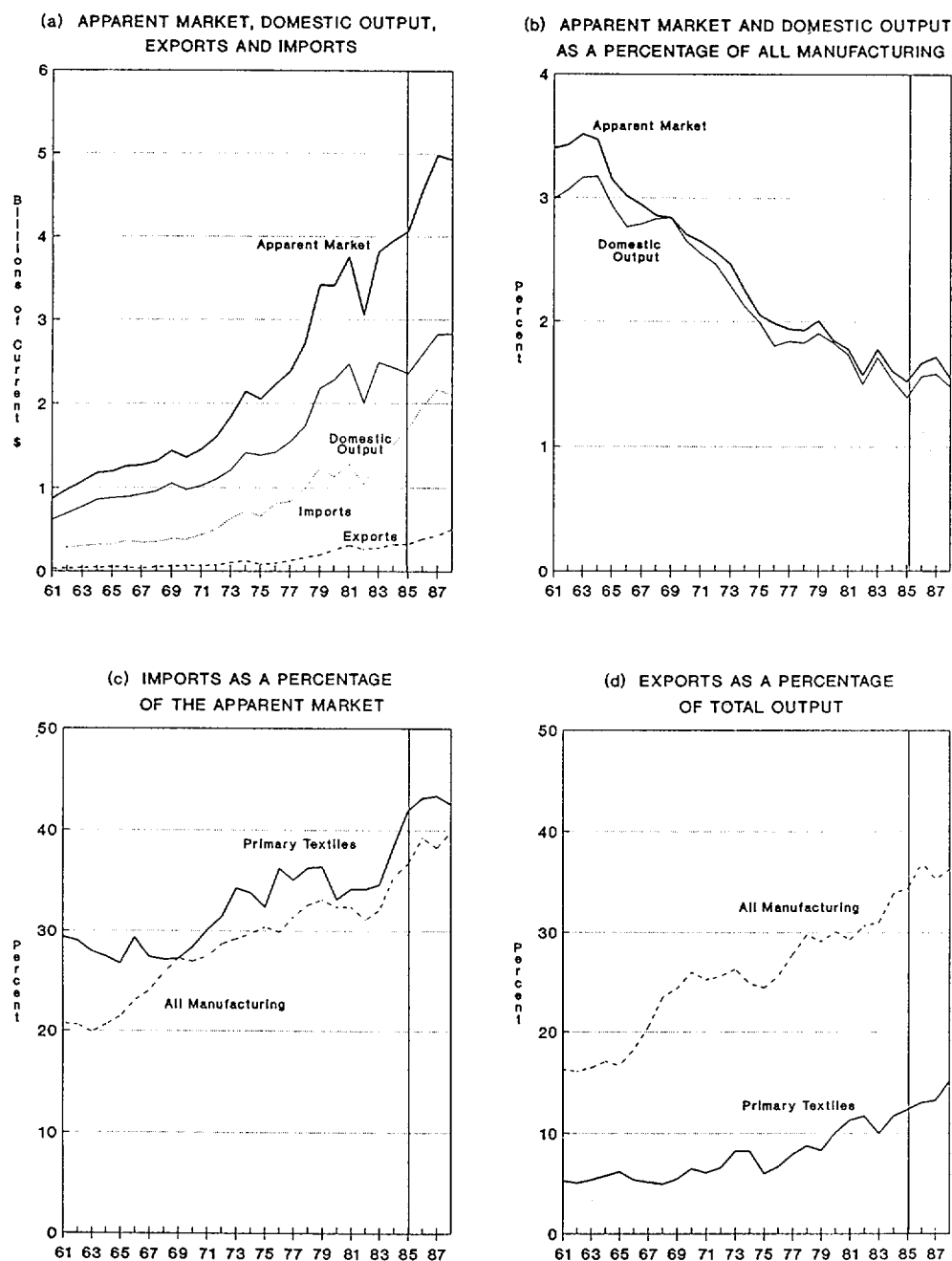
In testimony before the Tribunal, technological upgrading, product line rationalization and the increasing importance of capital investment were discussed and confirmed by several representatives of Canadian textile companies. With the installation of upgraded machinery and equipment, the textile industry has become a more capital-intensive industry. Many textile industry witnesses confirmed that greater capital intensity in the Canadian textile industry has assisted its competitiveness at home and abroad.

Notwithstanding the improved competitiveness of the Canadian industry, some firms expected that imports from "low-cost" sources would continue to cause significant competitive pressures. Indeed, in their view, the modernization of the Canadian industry served only to keep pace with that occurring in the developing countries, while these countries continued to enjoy a labour cost advantage. The firms also expressed the concern that their main customer base, Canada's clothing industry, was being eroded by imports

1. It was not always possible to develop reliable statistics for the textile industry as defined for the purposes of this inquiry. In such cases, statistics for the SIC primary textile industry were used. The primary textile industry corresponds most closely to the textile industry defined for the purposes of this inquiry.

Figure 2.2

**PRIMARY TEXTILES
1961-88**



Notes: SIC primary textile industry.
Imports measured on a CIF duty paid basis.
1986-88 data are CITT estimates based on recent growth in shipments, imports and exports. See Volume 2 for explanation of the estimation procedure.

Sources: Statistics Canada Input-Output Table L Level of Aggregation. Information provided to CITT by Informetrica Limited.

from these sources. As well, they argued that tariffs were not nearly as effective as quotas in providing the level of protection from imports from "low-cost" countries that they believed necessary.

Other firms stressed the importance of non-price factors in competing for markets. These were particularly important in textile sales to the clothing industry where the development of close relations with the customer, just-in-time delivery, a good mix of products, continuity of supply and consistent quality were often more important than the selling price of the product. Some clothing firms expressed the view that non-price factors rendered certain fabrics less susceptible to pressure from "low-cost" imports. In an industry where rapidly changing fashion trends require that initial and repeat clothing orders be met quickly, the longer lead times required for offshore fabric sourcing give a locational advantage to domestic suppliers.

On the issue of import penetration, evidence of some textile firms suggested caution in interpreting the longer term trends. For example, as the Canadian textile industry moved out of the production of certain goods, it often needed to import these goods to complement its own product range or to use as an input in the production of a more processed textile product, for example, the importation of greige goods or yarns to be made into finished fabric.

In other testimony before the Tribunal, most textile firms indicated that the FTA offered interesting challenges. The firms saw themselves able to compete with US companies given sufficient time, prior to the elimination of tariffs on US imports, to establish business ties and distribution channels in the United States and to expand the scale of their operations in Canada.

Several firms feared that reductions in MFN tariffs would adversely affect their ability to generate sufficient profits to finance the investment programs required to compete under the FTA. Some multinational firms indicated that they may be more likely to invest in the United States if Canada, in moving to lower MFN textile tariffs, offered less overall protection from "low-cost" imports than the United States.

Textile firms generally argued against any reduction in tariffs on products from third countries. However, they contended that, if third-country tariff reductions were inescapable, a longer, rather than shorter, phase in period for the tariff reductions would help to mitigate the costs of adjustment.

Some multinational companies told the Tribunal that they were pursuing a program of product specialization and production rationalization aimed at a North American or global market. These firms expected to produce and export a smaller range of products, but in greater quantities than at present, and to increase imports of products produced by their parent or sister companies. One textile producer indicated, however, that it expected to maintain or expand the range of products being produced. This firm pointed to innovations in loom technology which added production flexibility and permitted textile manufacturers to economically produce a larger assortment of fabrics in smaller lots.

A range of corporate strategies was identified by textile firms in Canada as they position themselves to compete in the 1990s. **Dominion Textile Inc.** (Domtex) has focused its production on heavier weight clothing fabrics and industrial fabrics. The firm has become the world's largest producer of denim. During 1989, Domtex modernized and expanded its Drummondville plant making it a world-scale denim manufacturing facility. Through acquisition, the corporation has expanded its denim production in the United States. The company has also secured a leading position in the European workwear market through the acquisition of Europe's largest manufacturer of polycotton workwear and

leisurewear fabrics. In January 1990, Domtex announced its intention to acquire Textiles Dionne Inc., a Quebec-based producer of yarns.

Textiles Dionne Inc. has invested in the latest technology in order to keep its plants as competitive as possible. The company produces a variety of both basic and specialty yarns, and anticipates that it will be able to cope under the FTA, as long as greater pressures are not imposed through additional tariff reductions vis-à-vis other countries.

Du Pont Canada Inc., in conjunction with its parent, has rationalized production in North America and has applied for the immediate elimination of tariffs for a number of products under the FTA.¹ The firm has emphasized industrial fibre products for some time. Du Pont Canada Inc. has positioned itself to pursue export markets through specific product mandates.

The major objective of **Celanese Canada Inc.** (Celanese) has been to pursue export markets and to make the investments required to meet the demands of the technical evolution in the worldwide tire industry and the yarn spinning sector. Celanese has reduced its textile product line to fibre and yarn production, having divested itself of the company's fabric manufacturing facility in 1985 and its carpet manufacturing facility in 1981. The company has expanded its acetate facility and achieved substantial sales growth in Pacific Rim markets in 1988.

Consoltex Canada Inc. has emphasized the production of heavier weight clothing fabrics. The company introduced small batch production equipment which enables it to supply short-run, small volume orders, as well as engaging in longer production runs. This quick response capability has contributed to sales growth in Canada and to the supply of niche markets in the United States.

Through restructuring and equipment upgrading, together with the financial and technical backing which accompanied its acquisition by Innocan Inc., **Cleyn & Tinker Inc.** has readied itself to compete more actively in the United States. The company has pursued accelerated tariff reductions under the FTA. However, the large US mills have not supported Cleyn & Tinker's efforts due to higher US tariffs on wool fabrics.

The **Cambridge Group** has invested heavily in recent years to strengthen its position in the Canadian market and to withstand the effects of tariff reductions under the FTA. The spinning plant has been fully modernized and expanded. The yarn preparation and fabric weaving, dyeing and finishing operations in its towel mill have been upgraded. In both plants, new investments have resulted in increased productivity and better quality control.

Britex Limited has developed a marketing strategy based on the company's strength in producing a range of speciality products through short production runs. It expects to lose some of its Canadian market for standard products to US competitors, but to compensate by increasing sales of specialty products in the US market through niche marketing.

(d) Industry Performance, 1984-88

As part of the Tribunal's industry surveys, textile manufacturers were asked to complete a production-oriented questionnaire and to provide copies of their financial statements for the period 1984-88.² These surveys were carried out in order to assemble

1. For most of these products, agreement was reached for the accelerated elimination of tariffs in 1990 subject to approval processes in both countries.

2. Financial statements from 65 firms were analyzed representing up to 75 percent of the shipments in the textile industry, as defined for purposes of this inquiry. Industry questionnaires from 73 firms were analyzed representing up to 70 percent of the industry shipments. See Volume 2 for further discussion of the sample coverage.

detailed information on the performance of the fibre, yarn and fabric sectors of the Canadian textile industry.

The Clarkson Gordon analysis of the financial statements of the textile industry suggested that, in general, "the industry showed considerable strength in its financial performance over 1984-88, outperforming the manufacturing sector as a whole and its US counterpart industry on key measures of profitability. Fibre manufacturing has been somewhat of an exception, with net losses in early years but near average or above average returns in the past two years."¹

This assessment was based on a review of 13 financial performance indicators, including measures of sales growth, liquidity, leverage and financial returns. Details on these 13 indicators are shown in Volume 2 of this report. In making its assessment, Clarkson Gordon compared the textile survey results against public data in Canada and the United States. In commenting on the validity of the survey data, it concluded that "the [survey] data appear to be reasonably consistent with Statistics Canada data for both textiles and clothing, particularly since differing industry definitions and our efforts to segment firms' activities by industry could account for the remaining differences in the data."² It also noted that the most recent data from Statistics Canada were also based on a sample of firms rather than a comprehensive census. To some extent, Clarkson Gordon argued, the Tribunal's data could be superior to the sample data available from Statistics Canada, due to the audited nature of some of the Tribunal data and the greater attention paid to the classification by industry.

The reported return on equity for the sample of textile manufacturers showed that they were more profitable for their shareholders than other manufacturing industries in Canada or their counterpart industry in the United States. The 16 percent average return on equity over the study period compared favourably with the Canadian manufacturing average of 12 percent and the US textile mill products industry average of 12 percent over the 1984-88 period. As another measure of profitability, the textile industry recorded an average of 8 percent net income to total assets ratio from 1984 to 1988, compared to 6 percent for the Canadian manufacturing sector as a whole.

The results, when broken down between Quebec and Ontario, indicated that Ontario firms had shown the more favourable results with regard to financial performance, with a return on equity of 27 percent, for example, versus 11 percent for Quebec, 1984-88 average, and a net income to total assets ratio of 13 percent versus 6 percent for Quebec.

The staff analysis of the questionnaire replies of the fibre, yarn and fabric sectors of the domestic industry showed the **fibre sector** as experiencing the smallest overall increase in total output with a level of import penetration comparable to the textile industry average (see Figure 2.3). Fibre producers achieved the greatest improvements in labour productivity of any sector and, coupled with only modest growth in output, saw a substantial reduction in their workforce. Financial performance, as reported in the Clarkson Gordon analysis, lagged the industry average, but showed a marked improvement over the 1984-88 period. This sector had the highest export to total output ratio in the industry, reflecting the greater specialization of production and the international nature of the market.

For the **yarn sector**, the growth in output, level of import penetration and the export ratio were comparable to the overall textile industry average. However, it was the

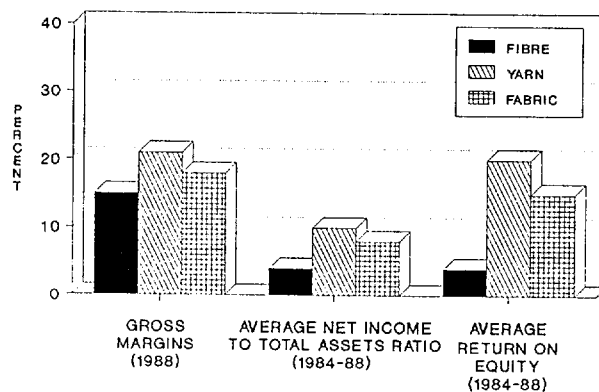
1. Financial Analysis of the Canadian Textile and Downstream Industries, 1984-88, Clarkson Gordon, October 1989.

2. Ibid.

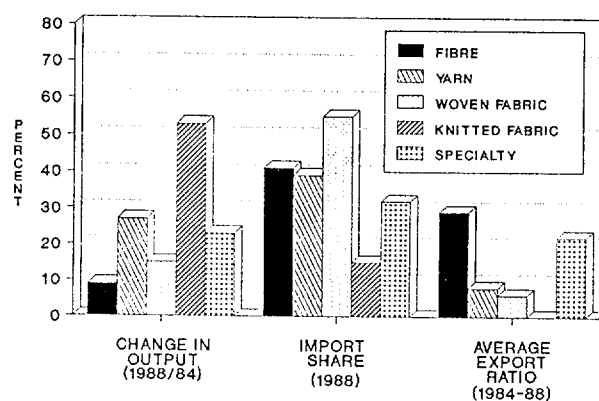
Figure 2.3

TEXTILE INDUSTRY INDICATORS 1984-88

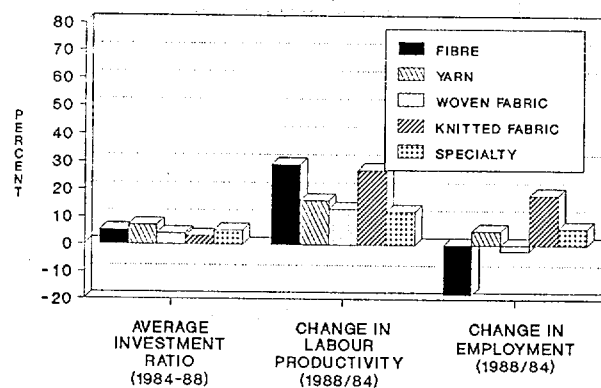
FINANCIAL



MARKET



OTHER



Sources: CITT survey and Clarkson Gordon.

man-made yarn component which drove this sector, as the natural yarn component reported almost no growth and little exports and faced a high, although declining, level of import penetration. The financial performance of the sector exceeded the industry average for returns on equity and assets. Gross margins for the man-made and natural yarn manufacturers were comparable in 1988. This sector also had the highest investment to output ratio in the industry with the investment ratio being higher in the natural yarn component. Advances in labour productivity for the sector were comparable to the industry average.

The **fabric sector**, as analyzed, contained three major components consisting of broadwoven fabrics, knitted fabrics and specialty textiles. The performance of the fabric sector, as measured by most of the indicators, was close to the textile industry average. Within the fabric sector, the output growth of the **broadwoven fabric** component was lower than the textile industry average. It faced a high level of import penetration and had a low export to output ratio. It reported a moderate gain in labour productivity and a somewhat reduced employment level. The man-made portion of the broadwoven fabric sector surpassed the natural portion in most measures of performance, including output growth, market share, exports, investment and gross margins.

The **knitted fabric** component had the highest growth in output over the period, very low exports and the lowest level of import penetration in the industry. The high output growth was paralleled by substantial gains in labour productivity and increased employment. Knitted fabric producers recorded the lowest gross margins in the fabric sector.

The **specialty textile** sector was defined, for the purposes of this analysis, to include a number of distinct products, including coated fabrics, papermakers' and other felts, tire cord fabrics and narrow fabrics. This sector registered average growth in output, faced lower than average import penetration and had the second highest export to output ratio in the industry. The sector also had moderate gains in labour productivity.

(e) Sales Distribution

The markets for textiles changed somewhat during the 1984-88 survey period. Clothing remained the dominant market for the industry, although declining from 45 percent to 41 percent of sales. Sales for household use, mainly carpets, increased marginally to 16 percent, while sales to the upholstered furniture market declined marginally to 6 percent. Sales for other use, mainly industrial applications, increased marginally to 22 percent, while exports increased from 11 percent to 15 percent. The man-made yarn, man-made fabric and specialty textile sectors contributed the most to the increase in exports.

(f) The 1984-88 Performance In Context

The strong performance of the Canadian textile industry, from 1984 to 1988, as suggested by an analysis of the survey responses, is also shown in published statistics. Table 2.4 shows that, for the same period, the textile industry exceeded all manufacturing in terms of growth in real domestic product, labour productivity and capacity utilization. It has, however, fallen behind in terms of new investment and employment growth. Of particular note in the table is the fact that labour productivity in the textile industry approached that for all manufacturing in 1988.

<p align="center">Table 2.4 SUMMARY STATISTICS FOR TEXTILES 1984-88 (Values Expressed in 1988 Dollars)</p>			
	1984	1988	AAI(%) 1984-88
REAL DOMESTIC PRODUCT (millions of dollars)			
Textiles*	1,256	1,638	6.9
All Manufacturing	82,667	99,124	4.6
% of Mfg.	1.5	1.7	
TOTAL EMPLOYMENT (000's)			
Textiles*	34	33	-0.7
All Manufacturing	1,722	1,913	2.7
% of Mfg.	2.0	1.7	
PRODUCTIVITY (RDP \$ 000/employee)			
Textiles*	37	50	7.8
All Manufacturing	48	52	2.0
% of Mfg.	77.1	96.2	
NEW INVESTMENT (millions of dollars)			
Textiles**	131	164	5.8
All Manufacturing	9,485	17,616	16.7
% of Mfg.	1.4	0.9	
NEW INVESTMENT (% of RDP)			
Textiles**	10.4	10.0	-1.0
All Manufacturing	11.5	17.8	11.5
% of Mfg.	90.4	56.2	
CAPACITY UTILIZATION			
Textiles***	80	97	4.9
All Manufacturing	78	83	1.6
<p>Notes: * Textile industry as defined for purposes of the proposed tariff reductions. See Volume 2 for an explanation of the estimation procedure. ** Primary textile industry (estimate). *** Primary textile industry. AAI = Average annual increase. RDP = Real domestic product.</p> <p>Sources: Statistics Canada Catalogues 13-001, 15-001, 34-250, 34-251 and 61-214 and CANSIM Matrices 4664 and 8003.</p>			

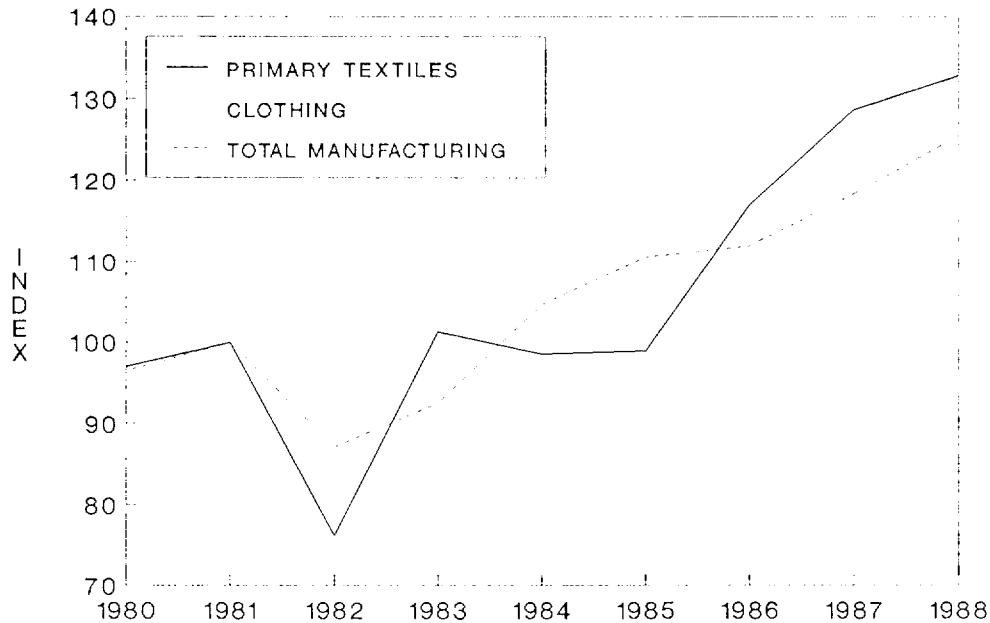
Notwithstanding the industry's overall strong performance, the textile industry has been more affected by cyclical developments in the 1980s than have the manufacturing industries overall, as shown in Figure 2.4. The primary textile industry was hit hard by the recession in the early 1980s - more so than either the clothing industry or all manufacturing. However, it outperformed the other sectors during the height of the cycle and outpaced the real output growth of both clothing and total manufacturing from 1981 to 1988.

5. Downstream Industries

There is a strong interdependence between the textile industry and downstream industries, such as clothing and home furnishings (including household textile products, carpets, upholstered furniture and mattresses). Other industries using textiles are not described in this chapter, as many markets are involved, and textile inputs generally account for a comparatively smaller percentage of overall production costs.

Figure 2.4

**INDEX OF RDP* FOR PRIMARY TEXTILES, CLOTHING
AND TOTAL MANUFACTURING**



Note: * RDP = Real domestic product measured in 1981 dollars.

Sources: Statistics Canada Catalogue 15-001 and CANSIM Matrix 4664.

The clothing and home furnishings industries employed approximately 145,000 people in 1988 compared to 33,000 people in the textile industry, as defined for the purpose of this inquiry. Shipments of the clothing and home furnishings industries amounted to \$9.1 billion in 1988 compared to \$3.9 billion for the textile industry. (See Figure 2.5)

(a) The Clothing Industry

In addition to a wide range of clothing for consumers, the clothing industry also produces garments for industrial and institutional use. Principal products include women's, men's and children's wear, foundation garments and a wide range of knitted clothing, such as T-shirts, underwear, sweaters and hosiery.

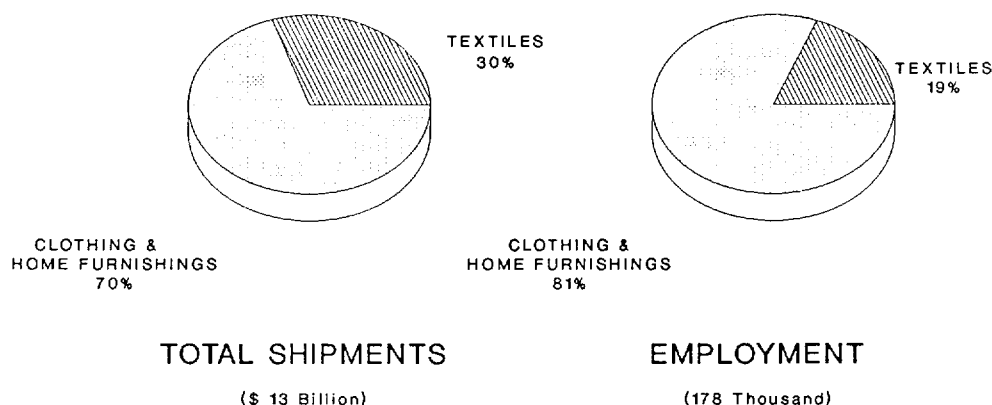
(i) The Industry and Its Market

The clothing industry is relatively labour-intensive and is generally made up of smaller companies than the textile industry. The more successful firms tend to stress responsiveness to changing trends, variety and design. Some of the major companies in the clothing industry are Dylex Limited, Nygard International Ltd. and the Algo Group Inc. As in the textile industry, the clothing industry has undertaken substantial restructuring. It has introduced automated processes to the design and cutting stages of production. Generally speaking, however, sewing remains quite labour-intensive.

Total employment in the clothing industry increased from nearly 111,000 people in 1984 to an estimated 120,000 people in 1988. The industry was concentrated in Quebec (57 percent of employment), Ontario (31 percent) and Manitoba (6 percent). Manufacturers

Figure 2.5

**TOTAL SHIPMENTS AND EMPLOYMENT FOR TEXTILE AND
CLOTHING & HOME FURNISHINGS INDUSTRIES
1988**



Sources: CITT survey and Statistics Canada.

were located primarily in large urban centres such as Montréal, Winnipeg and Toronto. Production of clothing accounted for 18 percent of the manufacturing employment in the Montréal area, 17 percent in the Winnipeg area and 6 percent in the Toronto area.¹

The apparent Canadian market for clothing was approximately \$8.2 billion in 1988. The market grew throughout the period, but growth slowed in 1988. Total shipments of Canadian firms were about \$6.4 billion in both 1987 and 1988. Although declining in 1988, exports recorded a sizable increase over the study period, but from a small base. Imports, over the 1984-88 period, captured an additional three percentage points of the apparent market. This is a similar import penetration trend as for manufacturing overall. It is, however, an import growth which is about twice as high as that for textiles. Nonetheless, in 1988, the domestic clothing industry met 72 percent of the domestic market demand, measured by value, compared to 60 percent for all manufacturing (see Table 2.5) and 59 percent for textiles.²

A longer term view of the industry is shown in Figure 2.6. In the 1961-88 period, the clothing industry, like the textile industry, accounted for a declining share of Canada's overall manufacturing industry. However, the clothing industry faced less import penetration in the domestic marketplace than either the textile industry or manufacturing in total.

1. Employment distribution data from: *Clothing Industry Profile*, ISTC, 1988.

2. In this calculation, imports are valued on an FOB basis. Measured on a CIF plus duty basis, the domestic clothing industry met 67 percent of the domestic market demand in 1988 compared to 59 percent for total manufacturing and 55 percent for textiles (CITT staff estimates). For a discussion of the "level of trade" measurement issue, see Volume 2.

<p style="text-align: center;">Table 2.5 APPARENT CANADIAN MARKET FOR CLOTHING 1984-88 (Millions of Dollars)</p>					
	1984	1985	1986	1987	1988
Total Shipments	5,175	5,543	6,016	6,350	6,374
Exports	287	322	398	464	425
Domestic Shipments	4,888	5,221	5,618	5,886	5,949
Imports (FOB)	1,603	1,683	2,050	2,259	2,298
Apparent Market	6,491	6,904	7,668	8,145	8,247
Domestic Shipments of Apparent Market (%)					
Clothing	75	76	73	72	72
Manufacturing*	64	63	61	62	60
<p>Note: • See Volume 2 for the apparent Canadian market table for all manufacturing.</p> <p>Sources: ISTC and Statistics Canada.</p>					

(ii) Clothing Industry Issues

In testimony before the Tribunal, many clothing makers described their competitive environment over the next few years as likely to be influenced by flat to marginal domestic growth prospects, continuing growth in imports and few offsetting prospects in export markets. As evidence of the existing competitive pressures, they pointed out that many clothing product groups have significant degrees of import penetration, particularly products like sweaters, outerwear, blouses and men's shirts.

The clothing makers felt that the export prospects for their industry were rendered uncertain by the FTA. Elimination of the duty drawback program in 1994,¹ the imposition of the double transformation rules² and the limited size of the tariff rate quotas³ were all seen as clouding the future.

The double transformation rules and the tariff rate quotas were viewed as limiting export opportunities, which might otherwise have been available through the FTA by restricting the use of offshore fabrics in garment production destined for the US market. Such goods would not meet the double transformation rules, and any export of them in excess of the tariff rate quotas would become, for US customs purposes, subject to

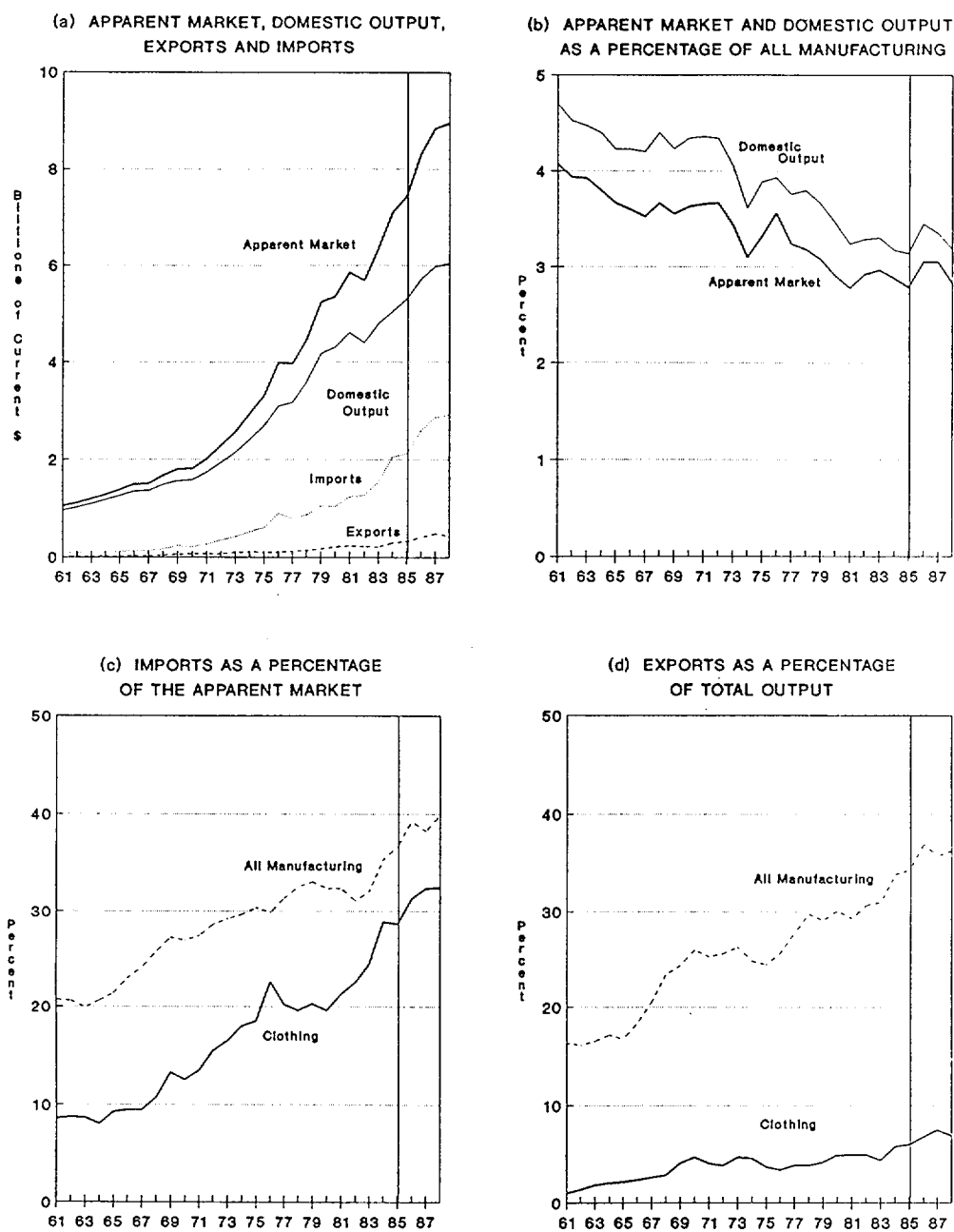
1. Generally, where imported materials are incorporated in goods which are subsequently exported, regulations provide for drawback of the duty paid on the imported materials. In the case of goods exported to the United States and benefiting from preferential treatment under the FTA, drawback of duties on third-country fabrics will not be permitted after the end of 1993. However, where goods are exported to the United States and are subject to MFN tariff rates, or exported to other countries, eligibility for drawback of duty on imported materials will continue.

2. Generally, to meet the "double transformation" rules and to be eligible for FTA rates of duty, clothing must be made from fabric that was at least woven or knitted in Canada or the United States, and the garment must have been cut and sewn in Canada or the United States.

3. The tariff rate quotas provide for 50 million square yards equivalent of non-woollen clothing and 6 million yards equivalent of woollen clothing to be permitted duty-free access to the United States annually when made of third-country fabric. The total quotas are subject to adjustment on agreement between Canada and the United States.

Figure 2.6

**CLOTHING
1961-88**



Notes: Imports measured on a CIF duty paid basis.
1986-88 data are CITT estimates based on recent growth in shipments, imports and exports. See Volume 2 for explanation of the estimation procedure.

Sources: Statistics Canada Input-Output Table L Level of Aggregation. Information provided to CITT by Informetrica Limited.

MFN tariffs and any quotas applicable to the products of that country from which the fabric was sourced.

The clothing industry argued that, with the FTA in place, it would experience difficulties in maintaining its current share of the domestic market, let alone expanding into export markets, if it could not achieve greater product differentiation from its US counterparts. To assist in achieving this product differentiation and to hold on to the domestic market in competition against US firms using US fabrics, it was necessary, the industry argued, to have cheaper access to offshore¹ fabrics which were different from those produced in Canada or the United States.

The clothing industry testified that its decision to purchase a variety of fashion fabrics offshore was driven essentially by the unavailability of many of these fabrics in Canada and the United States. Suppliers were needed who could provide garment makers with the right product at the right time and who could respond quickly to their demands for new fabrics to meet changing fashion trends.

Notwithstanding their stated need to have better access to offshore fashion fabrics, clothing industry representatives made it clear that, where possible, they preferred to establish supply relationships with domestic suppliers, thus reducing or avoiding the risks involved in sourcing from foreign suppliers. The availability of domestically sourced fabrics was viewed by garment makers as a critical factor in permitting them to remain competitive in Canada.

(iii) Industry Performance 1984-88

The survey data² show that financial performance for the clothing industry, over the 1984-88 period, was generally superior to the Canadian manufacturing industry average.

The sample results for clothing and accessory manufacturers showed an average return on equity of 15.6 percent. This was well above the average of 12 percent for the Canadian manufacturing sector, but on a par with the 16 percent average returns in 1987-88 earned by the nine large clothing firms in the US Fortune 500. The return on equity was variable within individual product segments of the clothing industry. Women's and girls' product lines showed the highest average return on equity, at 20 percent. This was followed by men's and boys' product lines and accessories, both at 11 percent.

The clothing industry's net income to asset ratio of 6.5 percent was comparable to 6.0 percent for Canadian manufacturing. Once again, there was considerable variability by product line. Women's and girls' led the way at 8 percent, followed by men's and boys' at 5 percent and accessories at 4 percent.

(iv) Raw Material Costs and Sourcing

The survey of clothing³ and other textile product manufacturers collected information on the sourcing and cost of textile raw materials used in the manufacture of downstream industry products.

1. Throughout this report, terms such as offshore, rest of the world or third-country imports refer generally to imports from all countries excluding the United States.

2. Financial statements from 162 firms were analyzed representing about 33 percent of the shipments in the Canadian clothing industry. See Volume 2 for further discussion of the sample coverage.

3. Questionnaires from 133 firms were analyzed representing about 22 percent of the shipments in the Canadian clothing industry. See Volume 2 for further discussion of the sample coverage.

For the clothing industry, the use of domestically produced material has been diminishing, from 51 percent in 1984 to 47 percent in 1988. As a source of textile raw materials, the United States accounted for about 11 percent, while offshore suppliers moved up from 37 percent in 1984 to 42 percent in 1988.

Of the three main categories of textile materials used in the manufacturing of clothing (i.e., yarns, knitted fabrics and woven fabrics), yarn was reported as having the highest level of domestic sourcing, but the trend was downward, from 81 percent in 1984 to 72 percent in 1988. The decreased domestic sourcing has been mainly to the advantage of US suppliers.

Between 1984 and 1988, clothing makers bought an increased proportion of their woven fabrics from outside Canada. Suppliers in countries other than the United States supplied 51 percent of domestic clothing makers' woven fabrics in 1988, up from 46 percent in 1984. US suppliers provided about 9-12 percent of total needs. Domestic sourcing of woven fabrics decreased from 43 percent in 1984 to 39 percent in 1988.

In contrast, the sourcing pattern of knitted fabrics remained relatively stable in the 1984-88 period. Sourcing of producers' requirements from local suppliers was in the 62-65 percent range, 21-22 percent from the United States and 14-17 percent from offshore.

For clothing producers, textile raw material costs accounted for about 47 percent of overall production costs in 1988. This proportion was the same for garments using knitted or woven fabrics.

However, textile raw material costs as a percentage of total production costs varied significantly from one product category to another, ranging from 22 percent in the case of men's woven jackets to 58 percent in the case of the women's slip category. In broad terms, the higher the percentage of textile raw materials and the more such materials are sourced from offshore suppliers, the greater will be the effect of MFN tariff reductions on total production costs.

(v) Summary Statistics

Table 2.6 provides indicators of clothing industry performance for the period 1984-88. The table indicates that the clothing industry has not kept pace with the manufacturing sector in terms of growth in gross domestic product, productivity and new investment. Average employee productivity, measured by gross domestic product per employee, is less than half that of all manufacturing and remained steady from 1984 to 1988.

(b) The Home Furnishings Industries

Included in this group are producers of household textile products, such as bed linens, towels and drapes and manufacturers of carpets, mats and rugs, upholstered household furniture and mattresses. A number of these manufacturers are part of the textile industry represented by the CTI. Thus, while certain of the CTI's members will need to respond to increased competitive pressures brought about by tariff reductions, others will benefit from lower tariffs on imported raw materials.

Collectively, these industries had shipments of \$2.7 billion in 1988 (see Figure 2.7). Exports totalled \$236 million or 9 percent of total industry shipments. In 1988, the four industries employed an estimated 25,000 people. Establishments in Ontario accounted for 48 percent of the employment, Quebec 38 percent, with 14 percent of the employment located in other provinces.

<p style="text-align: center;">Table 2.6 SUMMARY STATISTICS FOR CLOTHING 1984-88 (Values Expressed in 1988 Dollars)</p>			
	1984	1988	AAI(%) 1984-88
REAL DOMESTIC PRODUCT (millions of dollars)			
Clothing	2,489	2,666	1.7
All Manufacturing	82,667	99,124	4.6
% of Mfg.	3.0	2.7	
TOTAL EMPLOYMENT (000's)			
Clothing	111	120	2.0
All Manufacturing	1,722	1,913	2.7
% of Mfg.	6.4	6.3	
PRODUCTIVITY (RDP \$ 000/employee)			
Clothing	22	22	0.0
All Manufacturing	48	52	2.0
% of Mfg.	45.8	42.3	
NEW INVESTMENT (millions of dollars)			
Clothing	44	51	3.8
All Manufacturing	9,485	17,616	16.7
% of Mfg.	0.5	0.3	
NEW INVESTMENT (% of RDP)			
Clothing	1.8	1.9	1.4
All Manufacturing	11.5	17.8	11.5
% of Mfg.	15.7	10.7	
CAPACITY UTILIZATION			
Clothing	85	86	0.3
All Manufacturing	78	83	1.6
<p>Notes: AAI = Average annual increase. RDP = Real domestic product. Sources: Statistics Canada Catalogues 13-001, 15-001, 34-252 and 61-214, and CANSIM Matrix 8003.</p>			

(I) Industry Issues

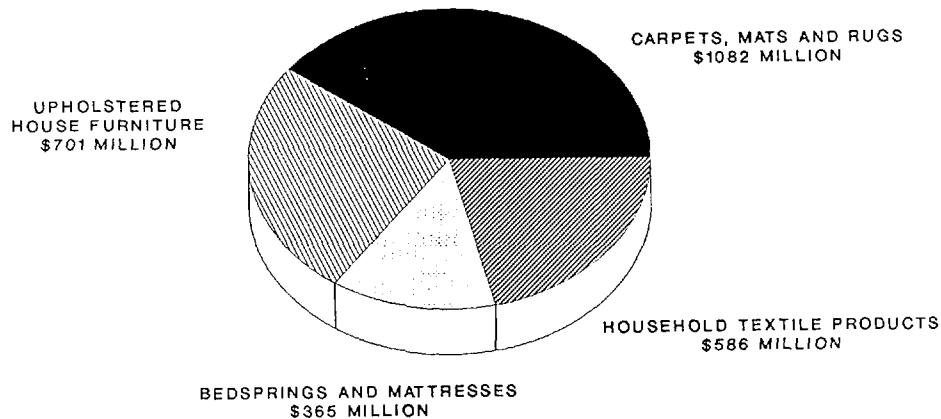
Producers of home furnishings expressed differing views as to the competitive environment. While import competition in some segments was said to be considerable, other segments were less susceptible to import penetration because of the nature of the business. For products such as carpets, for example, freight and inventory costs make serving the needs of the domestic market more difficult from outside Canada.

Most witnesses from the household textile products sector indicated that exports to the United States or elsewhere were not a significant part of their business. In contrast, upholstered furniture makers saw their future prospects as being significantly improved by exports if they secured tariff relief on fabric imports.

Like the clothing makers, the furniture producers were of the view that if they were to be successful in the future, particularly in the US market, they would have to achieve greater product differentiation from their US counterparts. They suggested that it was difficult to meet requirements for specialized fabrics from Canadian sources because of the limited number of lines available domestically.

Figure 2.7

**HOME FURNISHINGS INDUSTRIES
DISTRIBUTION OF TOTAL SHIPMENTS
1988**



Note: Total Shipments: \$2,734 million.

Source: Statistics Canada (unpublished - preliminary).

Upholstered furniture makers viewed with concern the fact that, under the FTA, their tariff protection would be reduced to zero in five years, while their fabric imports from the United States would continue to be subject to tariffs for an additional five years, placing them at a cost disadvantage with respect to their US competitors. However, in its announcement of November 30, 1989, concerning the agreement reached on the list of tariff lines and products for accelerated elimination of tariffs under the FTA, the Government indicated that both countries had agreed in principle to pursue, on an administratively acceptable basis, accelerated tariff elimination on fabrics of a kind used principally as decorative outer coverings in the manufacture of upholstered furniture.

(ii) Raw Material Costs and Sourcing

Textile raw materials accounted for varying proportions of total production costs for firms producing home furnishings. For household textile products, textile raw materials accounted for about 70 percent of total production costs, with 27 percent of the material sourced offshore. Domestic sourcing was 67 percent, and US sourcing was 6 percent in 1988.

In the case of carpets, mats and rugs, textile raw materials were reported to make up 59 percent of total production costs. Most of the materials (91 percent) were sourced domestically in 1988, with only minor quantities obtained from offshore suppliers other than those in the United States.

In the case of bedspring and mattress and upholstered household furniture products, only 16 percent of the total cost of production was represented by textile raw materials. Sourcing was 37 percent domestic, 55 percent from the United States and 8 percent offshore.

6. Highlights

During the 1970s and through the 1980s, the Canadian textile industry was transformed from a labour-intensive manufacturing sector to one that is more capital-intensive and technologically advanced. The transformation took place with government assistance and in the face of significant international competitive pressures.

Many textile manufacturers have also rationalized production by terminating unprofitable lines and concentrating on longer production runs of competitive products. This restructuring and rationalization has led to an improved overall level of capacity utilization, increased economies of scale and labour productivity improvements. Many industry participants expect this trend to continue as the Canadian industry positions itself in the North American market and takes advantage of market niches which are large by Canadian standards.

Historically, the industry has been geared to meeting domestic demand. However, export markets are becoming increasingly important, with some firms currently expanding their international marketing efforts. The industry has also sought to create new products and to diversify its market, notably in the field of industrial textiles.

As a whole, the industry is performing well. It has met the challenges of the last decade, and some sectors of the industry have attained internationally competitive levels of performance. In the 1984-88 period, the textile industry was profitable - more so than the Canadian manufacturing industry as a whole or the textile industry in the United States. This assessment, however, must be tempered by the cyclical nature of the Canadian textile industry's performance. During the 1980s, the industry performed worse at the bottom of the business cycle and better during the good economic times than Canadian manufacturing industry as a whole.

There is a strong interdependence between the Canadian textile and downstream industries. Over 60 percent of textile industry sales were to the Canadian clothing and home furnishings industries in 1988. Tariff reductions on third-country imports are expected to have the greatest effect on those products where textile raw materials represent a high proportion of overall production costs and where a high proportion of material is obtained outside North America or where domestic output is priced competitively with these sources.

The clothing industry sees the availability of a broad range of fabrics at competitive prices as an essential element of its competitiveness in both domestic and export markets. The clothing industry serves the Canadian market using a combination of domestically manufactured and imported fabrics. In the 1984-88 period, the industry faced greater import growth than the textile industry. It expects the competition in the domestic market to intensify under the FTA. To meet the competition, the clothing industry has increasingly been sourcing fabrics offshore. In 1988, offshore suppliers provided 42 percent of the industry's textile raw materials, up from 37 percent in 1984. The cost of these fabrics is an important aspect of the industry's competitiveness.

CHAPTER III

THE INTERNATIONAL SETTING

1. Introduction

In his letter of reference, the Minister of Finance observed that tariff reductions should be "consistent with the textile industry's ongoing efforts, through heavy investment and rationalization of production, to enhance the viability of its operations and to adjust to the international trading environment." The Tribunal, therefore, felt it was important to gain a general understanding of the international trading regime and global trade patterns that have characterized textile¹ and clothing trade since the 1960s. The first part of this chapter will briefly describe the major post-World War II developments related to the emergence of managed trade for textiles and clothing involving quantitative import controls or VERs under the MFA. While the preceding chapter looked at recent import trends from the perspective of the Canadian marketplace, this chapter will endeavour to situate these developments in a global, as well as a North American, context.

There was considerable debate among interested parties about the usefulness and appropriateness of studying quantitative import quotas or VERs. The textile industry felt that VERs had a protective effect that went beyond tariffs and it was, therefore, necessary to carry out a detailed study of both the Canadian and American VER regimes in order to accurately compare the two countries' textile tariff levels. The clothing industry emphasized that the Tribunal's terms of reference made no mention of VERs or other non-tariff barriers and, as these restraints were fluid trade measures which change with time, their study would not contribute to the Tribunal's work.

The Tribunal felt that it was important to examine carefully the VERs issue in an effort to decide how they affect the Canadian textile market and whether they have a measurable effect on trade over and above that given by tariffs. To this end, consultants in Canada and the United States were hired by the Tribunal to (1) provide detailed descriptions of the two countries' regimes; (2) compare their protective effect; and (3) advise on the manner in which tariff equivalents for VERs might be estimated. Testimony and submissions from interested parties on the subject were also carefully considered.

Our terms of reference also asked that we "take into account major changes which will be occurring in Canada's trading arrangements," such as "the Multilateral Trade Negotiations now in progress," in considering action "to lower the tariffs on textiles to a level more in line with those of other industrialized countries." Specific recommendations on the ultimate level to which textile tariffs should be reduced over the next 10 years were then to be made "bearing in mind Canada's objectives in the Uruguay Round of Multilateral Trade Negotiations (MTN) currently underway." This chapter will therefore finish by describing the relevant developments in the Uruguay Round which may affect future textiles and clothing trade.

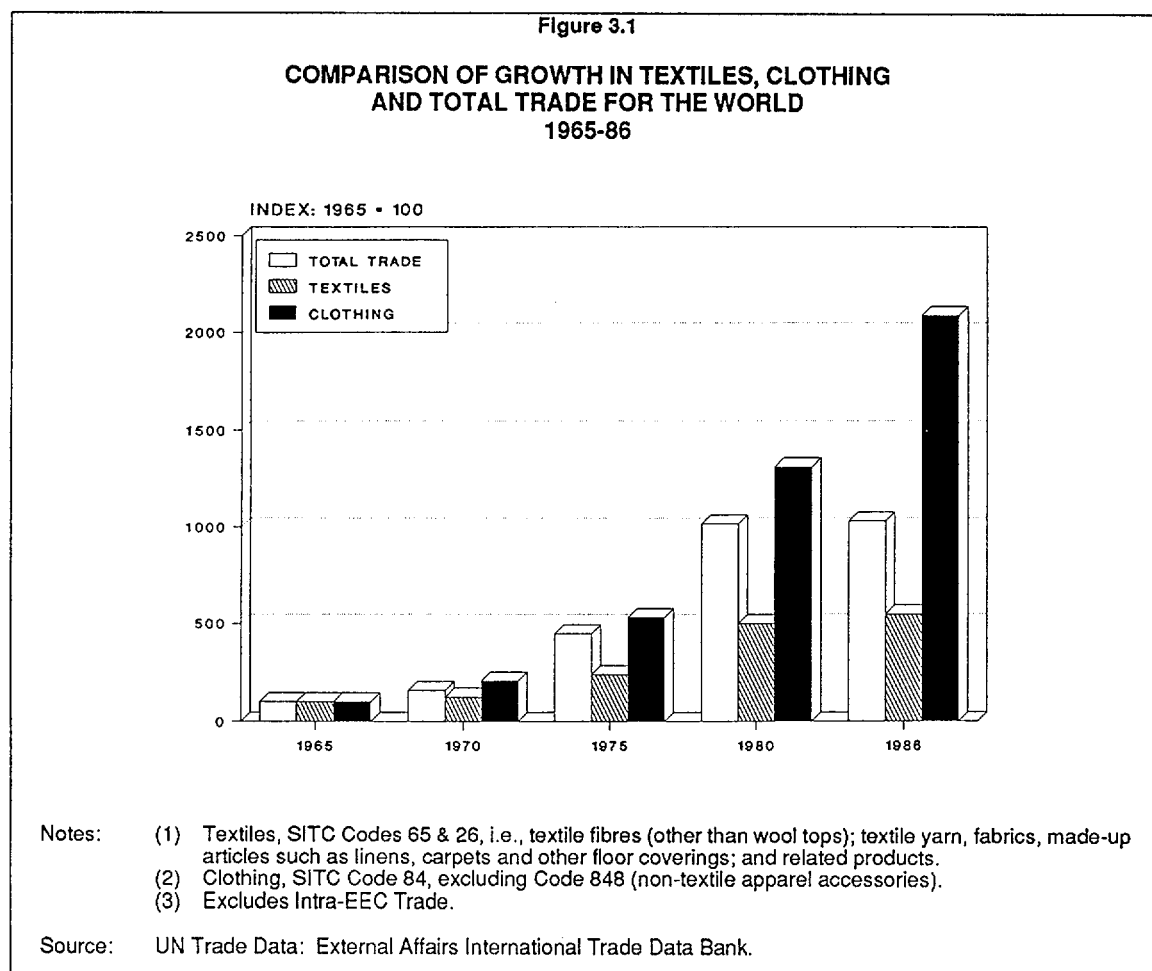
1. The term "textile" trade is often used to describe international trade in textiles, clothing and other textile products. Wherever possible, trade will be distinguished among these three groups of products. However, it may not always be possible to follow the definition of "textiles" presented at the outset of Chapter II. In such cases, a reasonable proxy will be identified and used instead.

2. The International Trading Regime

Textiles and clothing have been important products of international trade for many centuries and remain so today. Textiles and clothing have also been one of the most consistently managed areas of international trade in the post-World War II era of general trade liberalization. This regime of managed trade arose against the backdrop of a significant increase in production of textiles and clothing by the developing and centrally planned economy countries over the past 30 to 40 years. This growth was accompanied by a decline in the developed countries' share of world production of textiles and clothing. This decline is still continuing, according to the GATT Textiles Committee statistics. Table 3.1 shows that Canada and the United States were the only industrialized countries which increased their production of both textiles and clothing during the mid-1980s. It is also interesting that Canada's growth in production of textiles outpaced that of all other industrialized countries.

<p align="center">Table 3.1 PRODUCTION INDICES: TEXTILES AND CLOTHING⁽¹⁾ (1973 = 100, Except as Noted)</p>					
	Product	1984	1985	1986	1987
Brazil (1975 = 100)	Textiles	102.6	111.8	126.3	125.0
	Clothing	128.8	130.1	138.4	124.7
Canada	Textiles	111.2	111.9	116.1	124.9
	Clothing	101.7	102.3	106.3	115.0
Czechoslovakia	Textiles	143.6	147.4	151.0	X
	Clothing	140.1	146.4	149.2	X
EC(12)	Textiles	92.8	94.7	96.9	96.5
	Clothing	86.5	87.1	97.1	84.3
Hong Kong (1981 = 100)	Textiles	115.0	119.6	150.0	170.0
	Clothing	113.8	105.0	124.8	141.0
Hungary	Textiles	115.0	116.3	115.3	118.9
	Clothing	114.8	112.7	103.5	103.5
India	Textiles	106.7	113.8	117.0	X
	Clothing	99.4	103.8	100.2	X
Japan	Textiles	85.4	83.9	79.6	77.8
	Clothing	87.5	87.7	85.4	85.2
Korea	Textiles	325.5	325.2	354.1	386.6
	Clothing	488.3	498.4	547.1	606.5
Norway	Textiles	74.9	79.0	79.7	74.3
	Clothing	56.9	57.7	55.3	48.4
Singapore	Textiles	39.9	28.5	28.7	32.9
	Clothing	111.3	105.9	121.8	134.0
Switzerland	Textiles	100.0	103.7	106.1	103.3
	Clothing	93.0	91.5	94.1	86.1
USA	Textiles	106.5	105.5	113.8	118.4
	Clothing	115.4	113.4	116.4	120.7
<p>Notes: (1) Defined in accordance with Article 12 of the MFA and paragraph 24 of the 1986 Protocol. Index generally refers to value added at constant prices. X = Not available.</p>					
<p>Source: GATT Textiles Committee, Sub-Committee on Adjustment, <u>Report of the Sub-Committee on Adjustment</u>, COM-TEX/W'206, 15 September, 1988.</p>					

The restrictive or "managed" trade regime for textiles explains in good part the past two decades' relatively slow growth in textile trade worldwide. As Figure 3.1 shows, taking 1965 as the base year, world trade in textiles from 1965 to 1986 has grown more slowly than total trade, as well as clothing trade. Despite the fact that clothing trade has also been managed since 1962, the rapid growth in this area is probably explained by the continuing labour cost advantage of developing and centrally planned economies, as well as the low entry costs which have allowed many of the developing countries to enter the clothing market relatively quickly. Undoubtedly, this growth in clothing trade would have been even stronger under an unrestricted international trade regime.



In successive GATT rounds, textile and clothing tariffs have virtually escaped the tariff reductions which were negotiated for most other commodities. As a result, at the conclusion of the Tokyo Round of GATT multilateral trade negotiations in 1979, the textile tariffs of industrialized countries, with the exception of most natural fibres, generally stood at levels that were much higher than the tariffs applied to other commodities. While these high textile tariffs continue to restrict international textile trade today, non-tariff barriers are an equally important feature of the textile trading regime.

The most significant non-tariff barrier (NTB) affecting the textile and clothing trade is quantitative import controls, i.e., quotas or VERs. During the 1950s, the growth in US and UK imports of cotton textiles, especially from Japan, led to pressures to control these imports. In 1956, the United States negotiated a voluntary restraint agreement on cotton

textile exports with Japan for the period 1957-61. In the 1960s, restrictions on trade in natural fibres and the products thereof were multilateralized.

In response to the new international trading pressures created by the rapid development of the man-made fibre products industry, the Arrangement Regarding International Trade in Textiles, also called the Multi-fibre Agreement or MFA, was negotiated under GATT's auspices in the early 1970s. The MFA came into force in January 1974 and covered trade in most textile products (including clothing) manufactured from cotton, wool and man-made fibres. Both importing and exporting countries recognize that the MFA is an exception to the MFN principle of the GATT in that it permits import restrictions on a country-selective rather than a non-discriminatory basis.

For the past 16 years,¹ the essential condition for the conclusion of either unilateral restraint measures under Article 3 of the MFA or bilateral arrangements under Article 4 is the actual existence or the real risk of "market disruption" in the importing country. Whether it has acted through bilateral negotiations or through the imposition of unilateral measures, the importing country must provide to the Textile Surveillance Body (TSB) of the GATT credible market disruption evidence that establishes: (1) actual or threatened injury to the domestic industry and (2) that the injury is caused by a significant increase in imports or sales of imports at prices substantially below those prevailing for similar goods in the importing country.² Capacity utilization and profitability are among the factors considered in this injury determination.

3. Sources of Textile³ and Clothing Imports

(a) Canada

For the past quarter century, the United States has been Canada's principal source of **textile** imports. Imports from the United States and other developed countries are still more than double the level of imports from developing countries (69 percent versus 31 percent in 1987).

While Canada's imports of **clothing** from developing countries were very small in 1963, by 1973 imports from this source exceeded those from developed countries. In the period 1984-87, imports of clothing from developing countries reached almost triple the level of imports from developed country sources.⁴ (See Figure 3.2)

Between 1963 and 1987, Canada's combined imports (by value) of textiles and clothing increased much more rapidly from developing as compared to developed country sources. During this same period, the relative shift to developing country sources was much more pronounced in the case of clothing as compared to textiles. However, in the 1984-87 period, textiles was the area that saw the greatest growth in imports from developing countries. What seems to have occurred is a shift in sourcing of textiles from developed to developing countries, rather than an above average growth in textile imports. (Indeed, the average

1. The MFA was renewed in 1977 (MFA II), 1981 (MFA III) and 1986 (MFA IV). MFA IV expires in July 1991.

2. Annex A to the MFA.

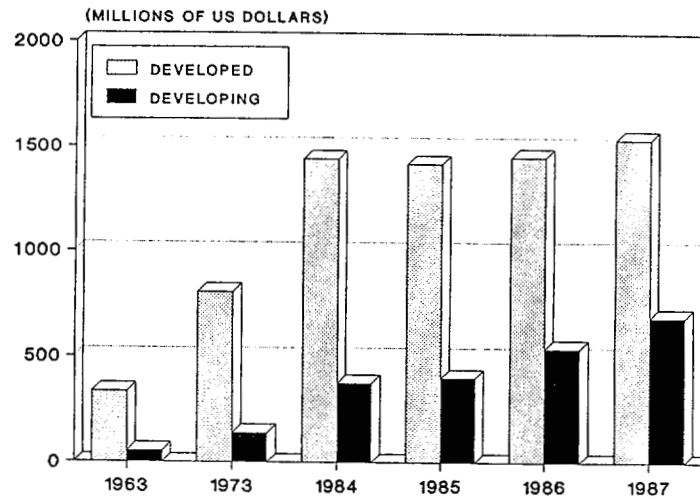
3. "Textiles" defined in accordance with SITC Codes 65 and 26; which include carpets and other consumer textile products. The definition is therefore somewhat broader than the textile industry, as defined for the purposes of this inquiry.

4. This development must be viewed against the background of significant growth in clothing imports from developing country sources in both 1983 (26 percent) and 1984 (17 percent). Summary of Canada's Bilateral Restraint Arrangements - Textiles and Clothing; Department of External Affairs, October 1987, p. 1.

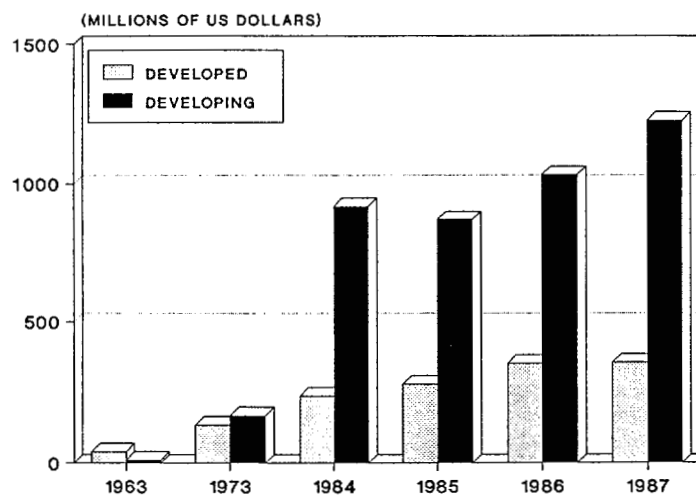
Figure 3.2

**TEXTILES AND CLOTHING: CANADA'S IMPORTS BY SOURCE
1963-87**

(a) TEXTILES



(b) CLOTHING



- Notes:
- (1) Textiles, SITC Codes 65 & 26.
 - (2) Clothing, SITC Code 84, excluding Code 848.
 - (3) Excludes Intra-EEC Trade.
 - (4) Developing includes Centrally Planned Economies (CPE).

Source: UN Trade Data: External Affairs International Trade Data Bank.

annual percentage change in Canada's textile imports from all sources for 1963 to 1987 is 8 percent and the same calculation for the period 1984-87 is 7 percent, indicating a slight decline in growth in total textile imports of late.) This shift in sourcing is most likely explained by an apparent relaxation in Canada's textile quotas in the post-1986 (MFA IV) period. (See Table 3.2)

<p style="text-align: center;">Table 3.2</p> <p style="text-align: center;">TEXTILES AND CLOTHING: CANADA'S GROWTH IN IMPORTS BY SOURCE</p> <p style="text-align: center;">1963-87</p> <p style="text-align: center;">(Millions of US Dollars)</p>									
		1963	1973	1984	1985	1986	1987	Average Annual Percent Change 1987/63	Average Annual Percent Change 1987/74
Textiles	Developed	334	804	1,438	1,415	1,447	1,532	7	2
	Developing	53	139	374	399	538	683	11	22
Clothing	Developed	40	135	236	278	351	355	10	15
	Developing	11	168	918	870	1,032	1,228	22	10
Total	Developed	374	940	1,638	1,693	1,798	1,886	7	7
	Developing	63	307	1,292	1,269	1,570	1,912	15	14
<p>Notes: (1) Textiles, SITC Codes 65 & 26. (2) Clothing, SITC Code 84, excluding Code 848. (3) Excludes Intra-EEC Trade. (4) Developing includes Centrally Planned Economies (CPE).</p> <p>Source: UN Trade Data: External Affairs International Trade Data Bank.</p>									

(b) United States

A large share of textile imports to the United States has traditionally come from developing country sources. In 1963, such imports represented approximately 41 percent of all US imports and, in 1987, imports from developing sources represented 51 percent of US imports. Japan is the US leading supplier of textiles in terms of value. Although not true in all cases, in general, the US textile mills' most severe competition from imports has been in the low-priced, lower quality products or in the high-priced, high-fashion products.¹ Figure 3.3 shows imports of textiles to the United States by source over the period 1963-87.

(c) Canada/US Comparison

When imports of textiles to Canada and the United States are compared for the period 1963-87, two facts emerge:

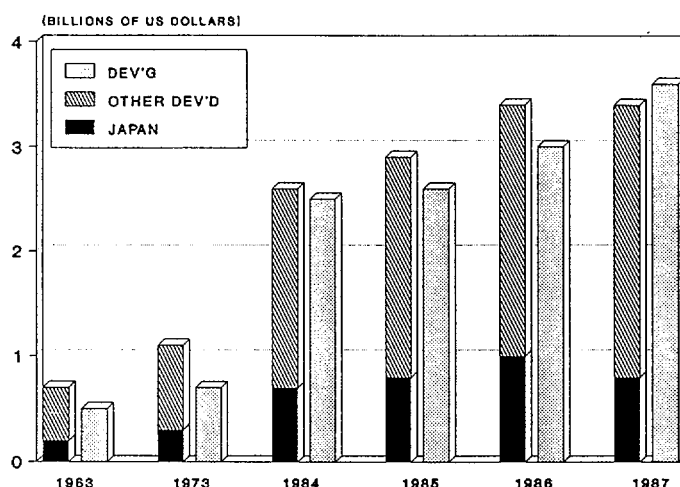
- (1) Canada's share of total textile imports sourced from developing and centrally planned economies, or so called "low-cost"² sources, continues to be much less than the US proportion of "low-cost" imports to total imports of textiles. (See Figure 3.4)

1. United States International Trade Commission (USITC) Publication No. 2048, pp. 4-6.

2. The term "low-cost" source refers to developing countries and centrally planned economies which are often subject to export restraints pursuant to the MFA. Use of the term does not necessarily mean that a country falling into this category is actually the lowest cost supplier for product X at any particular point in time. Indeed a review of data from the Department of External Affairs, Special Trade Relations Bureau, entitled Textile Import Table by Product for the Period 1983 to January - October 1989 shows that, in the case of many fabrics at least, the United States or another developed country is often the lowest unit price supplier.

Figure 3.3

US TEXTILE IMPORTS BY SOURCE 1963-87



- Notes: (1) Textiles, SITC Codes 65 & 26.
(2) Excludes Intra-EEC Trade.
(3) Developing includes Centrally Planned Economies (CPE).

Source: UN Trade Data: External Affairs International Trade Data Bank.

- (2) Canada's 8 percent average annual growth rate in textile imports from all sources was the same as that of the United States.¹

When a more disaggregated measurement of only **primary textiles** according to fibres, yarns, broadwoven fabrics and other fabrics is made, Canada's growth rate in imports is still lower than that of the United States for all but the fibre category.²

With respect to **clothing**, the shares of both countries' imports from "low-cost" sources are rather close. In 1987, Canada imported approximately 71 percent from "low-cost" sources and the United States, approximately 76 percent.³

As comparable market data were not available to calculate the share of the apparent market which "low-cost" imports held in Canada and the United States, a per capita value comparison of textile, clothing and all manufactured imports by Canada and the United States was examined as a reasonable proxy for the unavailable market data. The analysis showed that:

- (1) for all manufactured goods, Canada is more dependent on imports than the United States;

1. See Volume 2 for a table comparing Canada's and US growth rates in textile imports. In the period 1984 to 1987, Canada's rate of growth from all sources was 7 percent versus the US 12 percent.

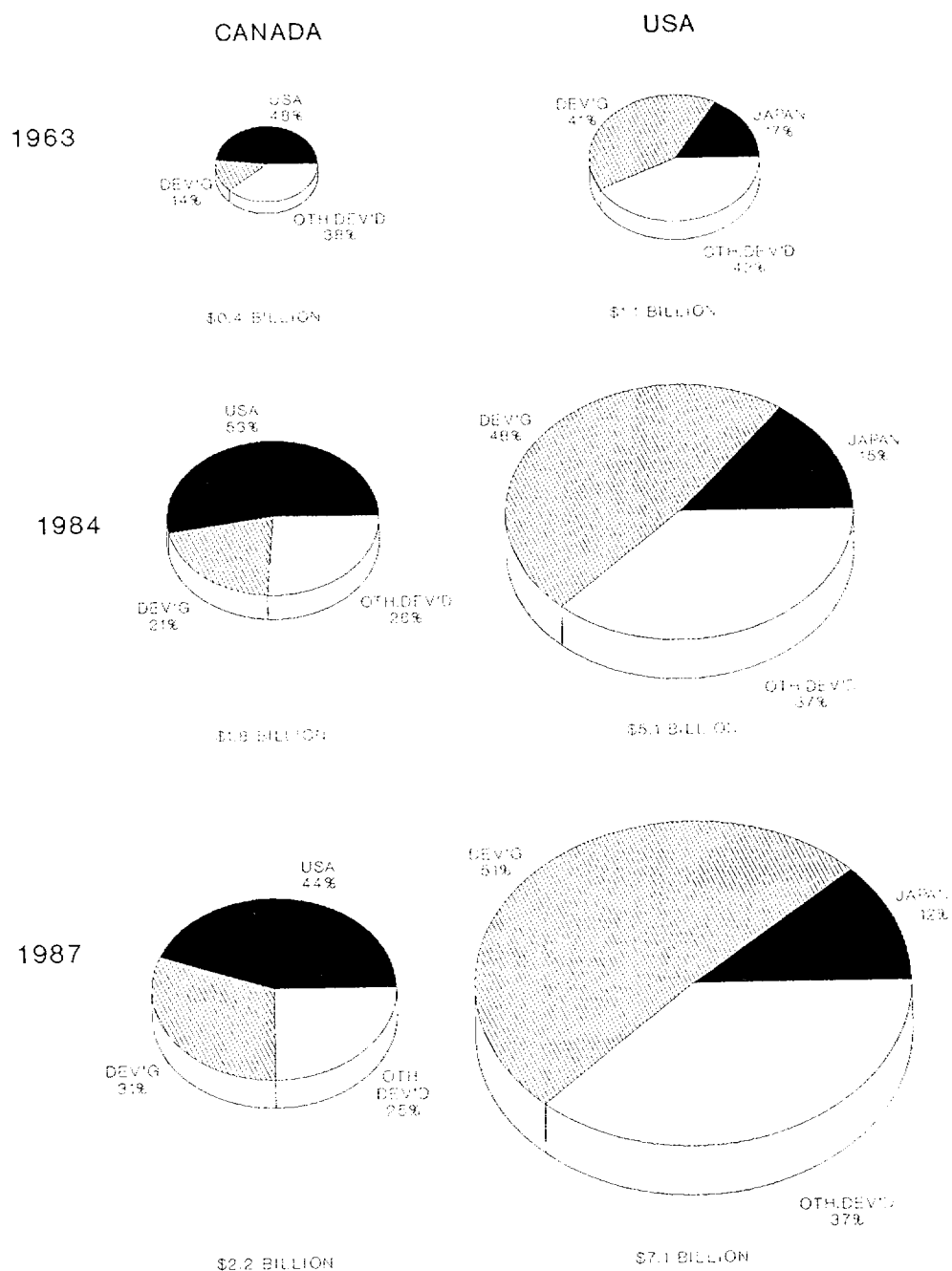
2. See Volume 2 for a table comparing Canada's, the US and the EEC growth in primary textile imports.

3. Sources: Canada: Total Imports, Clothing: Commodity Trade by Industrial Sector: Historical Summary 1983-87, Industry, Science and Technology Canada, 1988. Total Low Cost Imports, Clothing: CITT Consultant Report Doc. No. 3.11.2, Canada's Voluntary Export Restraint Regime, dated September 28, 1989.

United States: Total Imports, Clothing: Department of Commerce, 1989 U.S. Industrial Outlook, January 1989. Total Low Cost Imports, Clothing: United States International Trade Commission, U.S. Imports of Textiles and Apparel Under the Multifiber Arrangement: Statistical Report Through 1987. USITC Publication No. 2075, March 1988.

Figure 3.4

COMPARISON OF CANADA'S AND US
TEXTILE IMPORTS BY SOURCE
1963, 1984 AND 1987



Notes: (1) Textiles, SITC Codes 65 & 26.
(2) Excludes Intra-EEC Trade.
(3) Developing includes Centrally Planned Economies (CPE).

Source: UN Trade Data: External Affairs International Trade Data Bank.

- (2) for textile imports from all sources, Canada is also more dependent on imports than the United States (ratio 3 to 1);
- (3) for "low-cost" textile imports, Canada is again more dependent on imports than the United States, but less so than in either of the above-noted cases (ratio 2 to 1);
- (4) for combined textile and clothing imports from "low-cost" sources, Canada is less dependent on these sources than is the United States (\$73.97 per capita versus \$88.22 per capita in 1987); and
- (5) both countries had a similar average rate of increase in imports of textiles from "low-cost" sources during the period 1978-87.

4. Canada's VER Regime

Canada's bilateral textile restraint regime has evolved over 25 years. The regime has developed in line with:

- (1) the changing nature of Canada's textile and clothing industries;
- (2) the government's broad industrial and trade policy framework for the textile and clothing sectors; and
- (3) the changing pattern of textile and clothing imports into Canada.

At the beginning of 1990, Canada had a total of 29 restraints, of which 26 cover clothing products, 15 primary textiles and 10 household textile products. A review of these restraints indicates that:

- (1) Canada continues to rely on bilateral VER agreements as a major instrument to control imports, but is also prepared to use unilateral measures as appropriate;
- (2) the original emphasis on textiles has gradually shifted to clothing as more and more developing countries have entered the clothing exporting business;
- (3) restraints on textiles are concentrated on a limited number of sensitive products (more in the area of fabrics now than yarns); and
- (4) there continues to be a series of important restraints affecting household textile products (bedsheets, linens and cotton terry towels) and hosiery.

Over time, the product emphasis of Canada's coverage has changed, as has the list of countries with which Canada has concluded bilateral restraint agreements. This reflects the use of VERs to respond to changing imports, by product and source, which cause or threaten to cause market disruption. In this respect, the quota restraints of the MFA are very different from bound MFN tariffs; they are a more flexible and less structured feature of our protective system.

The Canadian textile industry testified that it benefited directly and indirectly from the restraints on household textile products and clothing. For example, several integrated textile companies manufacture household textile products, such as bedsheets and linens, and therefore benefit directly from restraints on the importation of those products. Representatives of the industry also agreed that restraints on imports of clothing and other

downstream textile products generally assist the industry by ensuring that it has a healthy customer base to purchase its fabric and, to a lesser extent, yarn products.

The Canadian textile industry's major sources of competition appear to vary depending on the product and the particular year. In certain instances, the main competition is from the "low-cost" sources which are restrained pursuant to the MFA. In other cases, the competition arises primarily from developed countries. Testimony at the June hearing showed that textile manufacturers themselves import a significant amount of textiles from both developing and developed country sources.

5. The US VER Regime

Since its 1957-61 VER agreement respecting cotton textile exports with Japan, the United States has relied on bilateral restraint arrangements as the basic instrument for controlling "low-cost" source imports of textiles and clothing. The United States started by emphasizing textiles, but, as clothing imports from developing sources grew, it began to place equal emphasis on their control.

In 1988, the United States had a total of 43 restraints, of which 39 cover clothing products, 27 primary textiles, and 14 consumer textile products.¹ The number of US bilateral agreements has grown over time. In late 1977, the United States had agreements with 18 countries, by mid-1984 with 28 and by 1988 with 43 countries.² The United States still considers Japan to be a "low-cost" source of textiles, but it is the only industrialized importing country to maintain a VER agreement with Japan.

US VER agreements are frequently amended to tighten or loosen controls, depending upon import penetration and domestic and international political and economic circumstances. In several agreements, such as with the Philippines, the number of specific restraints is modest when compared with the number of Designated Consultation Levels.³ Neither the United States nor the TSB of GATT regards a Designated Consultation Level as an actual restraint.⁴

The US industry has had fairly frequent recourse to countervailing duty and anti-dumping petitions. During 1984, countervailing duty petitions were filed against 13 countries, which together accounted for about 15 percent of the total quantity of US textile and clothing imports.⁵ These petitions appear to have assisted the US VER negotiators at certain crucial points when major suppliers were reluctant to agree on new import restraints.

6. Comparison of the Canadian and US VER Regimes

Table 3.3 provides a summary comparison of the countries of export and product groupings that Canada and the United States controlled through import restraints in 1988. The four major suppliers are highlighted.

1. Consumer textile products include carpets and other floor coverings, household linens, handbags and luggage.

2. USITC Publication No. 2222, October 1989, page 4-1.

3. These levels designate an amount of imports which may automatically trigger a request for consultations, by either side, to convert the level into a specific restraint. The specific restraint would be set at a higher level and probably have the benefit of flexibility provisions.

4. The Canadian industry, nevertheless, argued that Designated Consultation Levels were a substitute for actual restraints and that Canada should increase its use of these levels.

5. USITC Publication No. 1693, page 24.

Table 3.3

**CANADA/US
MFA IV VER REGIMES FOR TEXTILES AND CLOTHING**

Country	CANADA			USA		
	RT	RC	RP	RT	RC	RP
Bangladesh		X			X	
Brazil			X(U)	Y F	X	X
Bulgaria	F(7)	X			X(1)	
Burma					X(1)	
China, People's Rep.	F	X	X	Y F	X	X
Colombia				F(9)	X	X
Costa Rica					X(2)	
Czechoslovakia	F	X	X		X	
Dominican Republic		X(1+5)			X	
Egypt				Y F		
El Salvador				(10)		
German Dem. Rep.		X(3)			X(1)	
Guatemala				F(1)		
Haiti				X		X
Hong Kong	F	X	X(6)	Y F	X	X
Hungary		X(1)		Y F	X	
India	F	X		Y F	X	X
Indonesia		X		Y F	X	
Jamaica					X	
Japan				F Y	X	
Korea, Rep. of	Y F	X	X	Y F	X	
N. Korea	X(U)					
Macau		X			X	
Malaysia	Y	X		F Y	X	X
Maldives		X			X(1)	
Mauritius		X		Y	X	
Mexico				F Y	X	X
Nepal					X	
Pakistan		X	X	F Y	X	X
Panama					X(1)	
Peru				F	X	
Philippines	F	X		Y	X	
Poland	F	X	X	F	X	X
Romania	F	X	X	F Y	X	X
Singapore	Y	X		F Y	X	X
S. Africa	F(4)	X		Y(4)	X	
Sri Lanka		X			X	X
Taiwan	Y F	X	X	Y F	X	X
Thailand	F	X		Y F	X	X
Trinidad & Tobago					(10)	
Turkey		X	X	F Y	X	
United Arab Emirates					X(U)	
Uruguay	F(1)			F	X	
USSR				F(8)		
Vietnam		X				
Yugoslavia				Y F	X	

- Y = Yarn
 F = Fabric
 RT = Specific restraint for primary textiles, which could be Y or F
 RC = Specific restraint for clothing products; gloves, work gloves & liners and hosiery are included under this designation
 RP = Specific restraint for consumer textile products, e.g., bed linens, handbags, luggage
 (U) = Unilateral restraint
 (1) = Single product restraint
 (2) = In 1988 this became a single clothing product restraint; prior to 1988 it was a two-product restraint agreement
 (3) = Hosiery only
 (4) = Effective Jan. 1, 1989, to Dec. 31, 1991, in case of Canada; VER agreement in effect in 1985 only in case of USA and thereafter *Anti-Apartheid Act* embargoed all trade
 (5) = Cda/Dom. Republic Agreement awaiting ratification but being provisionally implemented since 1988
 (6) = Special Export Authorization system for many clothing products not subject to specific restraints
 (7) = Restraint on worsted fabric effective October 1988 forward
 (8) = Single product agreement for one year only
 (9) = In 1988 this became a single product, cotton fabric, control
 (10) = Designated Consultation Level only, no specific restraints

Source: Based on review of Canada and US restraint agreements and unilateral import restraints in effect from 1986 to 1988.

China, Hong Kong, Korea and Taiwan are regarded by Canada and the United States as their major "low-cost" suppliers, and each country controls both textile and clothing products from these four sources. Canada also controls household textile products from all four and the United States from all but Korea. Table 3.4 shows that utilization rates for textile quotas are roughly comparable; generally, the greater the utilization of a quota, the greater the likelihood of the quota having an effect on domestic supply and prices.

<p align="center">Table 3.4</p> <p align="center">CANADA/USA - 1988</p> <p align="center">A COMPARISON OF TEXTILE RESTRAINT UTILIZATION RATES BY "BIG FOUR"</p>								
	Hong Kong		South Korea		Taiwan		P. Rep. China	
	Canada	USA	Canada	USA	Canada	USA	Canada	USA
Yarns	-	-	64.7	75.6	111.0**	89.2	-	82.3
Fabrics	67.0	75.5	63.4	62.6	77.7	68.5	55.3	78.1
Average Yarns & Fabrics	67.0	75.5	64.0	64.8	83.1	71.2	55.3	78.7
<p>Note: ** Utilization above 100% as a result of flexibility provision utilization.</p> <p>Sources: Canadian data: Special Trade Relations Bureau, External Affairs and International Trade Canada; <u>Restraint Utilization by Product</u>, pp. 38, 7 & 37 dated April 8, 1989.</p> <p> US data: <u>Study of the US Textile & Apparel Restraint Program</u>; prepared by Sharretts, Paley, Carter & Blauvelt, P.C., for the CITT, July 31, 1989.</p>								

A recent GATT TSB Report¹ which reviewed all importing countries' actions under the MFA for the period August 1986 to June 1989 found Canada and the United States to be comparable, but different from the other MFA importers, in the following ways:

- (1) both have increased the number of restraint agreements under MFA IV, agreements which in general have a wider coverage, more restraints and growth rates and flexibility provisions² that are either unchanged or more strict than under MFA III;
- (2) the two are the only countries applying restraints under the MFA on products made of ramie type fibres;
- (3) the two are the only countries which negotiated aggregate or group limits; and
- (4) the two are the only countries to have imposed unilateral measures.

The TSB view respecting the control of textile and clothing imports is that both Canada and the United States are applying MFA IV more strictly than they applied MFA III and,

1. Report of the TSB to the Textiles Committee for the Major Review of the Operation of the Arrangement Regarding International Trade in Textiles, 1989. COM.TEX/SB/1490, 11 September 1989.

2. The major "flexibility provisions" are (1) swing - the percentage by which one restraint product may be increased by transfer from one or more other product restraints, through the application of appropriate conversion factors; (2) Carry Over (CO) - provides for the utilization in the current year of a portion of a restraint which was underutilized in the immediately preceding year; and (3) Borrow Forward (BF) - provides for the utilization in the current year of a portion of the restraint provided for the immediately succeeding year.

thus, have followed a trend contrary to that of all other importing countries. In short, both the Canadian and US textile and clothing industries appear to benefit from more quota protection than their western European counterparts.

Despite extensive efforts by research staff, consultants and interested parties to compare, both quantitatively and qualitatively, the two countries' regimes, the Tribunal has found it difficult to measure any significant difference in the protective effect of the VER regimes in Canada and the United States. Looking at the regimes themselves, it is clear that the United States now has a generally broader and more restrictive set of textile import controls than does Canada. There is also a widespread impression within the Canadian textile industry that the US regime has a greater protective effect because the United States controls more products from more sources. Furthermore, many in the industry felt that reducing Canadian tariffs to US levels, without making allowance for differences in the two VER regimes, would leave Canadian producers with less overall protection than their counterparts in the United States. However, the industry was not able to offer conclusive quantitative evidence to buttress these impressions.

The Tribunal has noted that the textile trade and production patterns in Canada and the United States are very different. Canada does not produce as broad a range of textile products as does the United States. Further, developing countries subject to possible control under the MFA represent the major source of imports in the US market, whereas Canada faces higher levels of import penetration from other developed countries. It has not been possible, therefore, for Canada to establish cases of market disruption for as broad a range of products and country sources as has the United States. However, where Canada can and has been able to meet the MFA's test of market disruption, it has protected itself, as has the United States. The Tribunal concludes that apparent differences in the VER regimes between Canada and the United States (e.g., the product and country coverages in Table 3.3) largely reflect the two countries' different textile production and import patterns.

It has become equally clear following our study of VERs that these export restraints are a fluid and specific safeguard measure whose effectiveness changes from year to year. In the clothing area, for example, where consultants for the Tribunal were able to derive quantitative estimates of the tariff equivalents of a selected number of clothing products from Hong Kong over the 1985-88 period,¹ the effectiveness of quotas varied enormously from month to month and year to year. In contrast, tariffs are more structured, more durable and more predictable in their protective effects. The Tribunal concluded that it would not be productive or desirable to attempt to convert VERs into tariff equivalents in order to compare the overall level of protection for textiles in the two countries.²

It is true that Canada's imports of textiles³ from developing countries increased at a faster rate than those of the United States for the 1963-87 period, as well as for the period 1984-87. It is also true that the growth rates of textile imports from all countries into Canada have been no greater than for the United States over these same periods.

On balance, therefore, the Tribunal concludes that there are indications that the US VER regime is more protective than Canada's, but that the evidence is not conclusive. Although Canada's import restraint regime for textiles does not now appear to be as restrictive as that of the United States, we have decided that it would be unwise to base

1. Institute for Research on Public Policy, Tariff Equivalents for Bilateral Export Restraints on Canada's Textile and Apparel Trade: Analytical Issues, Measurement Methodologies, and Selected Estimates, September 28, 1989.

2. Assuming a reliable method and the necessary data could be found - a questionable assumption at best.

3. Textiles defined in accordance with SITC Codes 65 and 26.

tariff comparisons on any impression of potentially transitory differences between Canadian and US VER regimes at a particular point in time.

7. MTN - Uruguay Round

(a) Overview

At the commencement of the Uruguay Round of multilateral trade negotiations in September 1986, participating Ministers agreed that "negotiations in the area of textiles and clothing shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened rules and disciplines."¹ Ministers also agreed that market access negotiations should "reduce or as appropriate eliminate tariffs including the reduction or elimination of high tariffs and tariff escalation."² It was, therefore, clear from the outset of the Round that textile and clothing trade could be significantly affected by these negotiations, in the area of both tariff and non-tariff barriers.

At the December 1988 Mid-Term Review Meeting, GATT parties agreed to work towards:

- (1) an overall target for reductions of tariffs of at least one-third with gradual phasing;
- (2) a substantial increase in bindings; and
- (3) substantial reductions or elimination of high tariffs, tariff peaks, tariff escalation and low tariffs.³

In the summer and fall of 1989, market access proposals were tabled in the Negotiating Group on Market Access by the EEC, Japan and Canada. All three parties favour a formula approach to negotiate tariff reductions of 33 percent or more,⁴ with the possibility of a request/offer approach to achieve tariff reductions deeper than the formula cuts or to reduce tariffs on particularly sensitive products. In principle, there would be no product grouping excluded from the tariff reductions.

The United States has indicated that it favours the request/offer approach in order to ensure that no sectors are excluded - as had been the case in the past when formulas were used. By September 1989, the United States had tabled 14 request lists in pursuit of its tariff and non-tariff barrier objectives. The United States later indicated that it would not object to having other parties use the formula approach to cut tariffs, but it would evaluate trading partners' requests on the basis of its product specific approach.

As of the end of 1989, the Chairman of the Negotiating Group on Market Access was still trying to build a consensus on an overall approach for the tariff negotiations and had suggested a framework similar to that proposed by Canada (i.e., a formula supplemented by a bilateral request/offer procedure).

1. GATT Document, Ministerial Declaration of September 20, 1986, page 5.

2. Ibid, page 5.

3. GATT Document MTN.TN/7 (Min.), page 4.

4. The Canadian Market Access Proposal tabled September 25, 1989, proposes a maximum formula rate of reduction of 38 percent and also suggests that the tariff formula reduction be applied to all sectors.

Deliberations in the Negotiating Group on Textiles and Clothing have been focused on the methods and time frames for bringing textiles and clothing into the GATT following the expiry of MFA IV in July 1991. These negotiations, if successful, would lead to the gradual dismantling of the MFA during an agreed transition period. Quotas could be progressively liberalized or gradually eliminated during this period, perhaps on both a product line and country basis or on the basis of a global quota which would differentiate between products but not countries.

As a result of the MTN market access deliberations, it is likely that tariffs on textiles will be lowered. However, it may not be clear until the end of 1990 whether textile tariffs will be reduced by the target rate of one-third. Lower than formula cuts might reflect significant efforts to liberalize textile trade in other respects, notably in relaxing or phasing out the MFA. Higher than formula cuts would be consistent with the stated MTN goal of eliminating the highest peaks in the developed countries' tariffs on industrialized goods.

Unfortunately, insufficient progress has been achieved to date to be able to predict more precisely how the trading regime for textiles and clothing could change as a result of the Uruguay Round of negotiations. Furthermore, negotiations in other apparently unrelated areas will directly and indirectly affect textiles. For example, progress in areas of crucial importance for major players, such as intellectual property, import safeguards and agriculture, will probably interplay with the development of options and negotiated solutions for textiles and clothing.

(b) Views of Interested Parties

Interested parties representing the textile industry at both the June and October hearings were concerned that Canada would damage its ability to extract tariff concessions of interest from others in the Uruguay Round as a result of the proposed introduction of textile tariff cuts by the Government in 1990. Textile industry representatives urged us to recommend that no tariff cuts arising from this inquiry should occur until after the completion of the Uruguay Round. At that time, the Government could assess how or when to implement our recommendations in light of achievements in the Round and concessions made by other parties. On the issue of concessions by our trading partners, textile producers argued that, in return for reducing our textile tariffs, Canada should receive credit in the form of improved access in the textile area and not trade off textile tariff cuts for progress in other negotiating areas.

Witnesses from the textile industry also expressed many concerns about the outcome of the MTN. They worried that the industry might face two new sets of tariff reductions - those which we recommend and those arising from the MTN. When combined with tariff reductions under the FTA, this would amount to a massive loss of protection over a short period of time. In their view, the Government should not proceed with any unilateral tariff reductions until the results of the MTN are known and the textile industry has had more time to adjust to FTA tariff reductions.

Representatives of the clothing industry dismissed any concerns about prejudicing Canada's ability to extract tariff concessions from the MTN as a result of unilateral textile tariff reductions. They took for granted that the Government would not bind any unilateral tariff reductions unless it got credit for doing so in the Uruguay Round of MTN now in progress and were confident that the binding of a rate had considerable value in the GATT. They argued that the GATT emphasized not merely reductions in tariffs but their binding at lower rates. Mutual concessions are therefore made on the basis of tariff bindings.

(c) Tribunal's Views

Our interpretation of the terms of reference was that the tariff reductions we are recommending and the tariff reductions arising from the MTN should proceed on two quite separate paths. The Government's objective as expressed in our terms of reference is to bring about a relative adjustment in Canadian textile tariffs vis-à-vis tariffs in the United States and other industrialized countries. The objective of the MTN is to reduce tariffs of all participants. To put forward the Tribunal's tariff recommendations as the Canadian negotiating position in the GATT would be to ignore the basic objective of adjusting Canadian textile tariff levels vis-à-vis those of our industrialized competitors. For this reason, we believe that any tariff reductions agreed upon in the GATT should be additional to the tariff reductions we are recommending.

We fully appreciate the importance of achieving negotiating credit for the tariff reductions we recommend. We are equally cognizant of the GATT Ministers' agreement, at the December 1988 Mid-Term Review Meeting in Montréal, that credit should be given for bindings and that participants should also receive appropriate recognition for liberalization measures adopted since June 1986.

8. Highlights

Textile trade has long been subject to restrictions. In the post-World War II era these trade restrictions have taken the form of high tariffs and quantitative import controls or VERs. The latter are implemented pursuant to the MFA which entered into force in 1974 and exists today in the form of the 1986 Protocol of Extension, expiring on July 31, 1991.

These trade restrictive developments occurred against the background of the emergence of strong textile and clothing industries in the developing and centrally planned economies (together referred to as "low-cost" sources) during the 1950s and 1960s - a trend which has continued into the 1980s as the poorer developing countries began to produce larger volumes of export competitive textile and clothing products.

In order to protect their own important textile and clothing industries, developed countries such as Canada make use of VERs to control the growth of import penetration from "low-cost" sources. A review of Canada's existing 29 restraints indicates that the original emphasis on textile restraints has gradually shifted to clothing. However, there continues to be a number of important restraints on sensitive fabric and yarn products, as well as certain household textile products and hosiery.

The United States also relies heavily on VERs to control textile and clothing imports and had 43 restraints in place in 1988.

The textile production patterns in Canada and the United States are very different, with Canada producing a smaller range of textile products than the United States.

In contrast to Canada, the United States obtains a majority (51 percent in 1987) of its textile imports from "low-cost" sources whereas Canada acquires less than a third of its imports from these developing country and centrally planned economy sources. Canada's average annual growth in textile imports from all sources during 1963 to 1987 was equal to that of the United States. However, in the 1984-87 period, the growth was less than the US rate, in spite of Canada's recent growth in textile imports from developing countries.

Even with all the results of the extensive VER analysis before us, the Tribunal was not able to arrive at a precise picture of the comparative protective effect of Canadian and US VER regimes. We did, however, feel that the quota coverage in the United States is broader and more restrictive than in Canada.

It also became clear that VERs are a fluid and specific safeguard measure, while tariffs have a more structured character and are applied on an MFN basis.

For all the above reasons, the Tribunal considered it unwise to base tariff comparisons on any impression of differences in VER regimes between Canada and the United States at any particular point in time.

This conclusion has also been formed against the knowledge that, while the Uruguay Round of MTN now in progress has, as one of its objectives, the eventual integration of this sector into GATT on the basis of strengthened rules and disciplines, an MFA-like trade regime will probably exist until the turn of the century, although import quotas would probably be progressively liberalized or gradually eliminated during the next decade.

The Uruguay Round is also working towards an overall target for reductions of tariffs of at least one-third with gradual phasing. While textile and clothing products will not be immune from these tariff cuts, it is not yet known whether textile tariffs will be reduced by the target rate, more, or less.

The Tribunal's interpretation of the terms of reference is that the tariff reductions we are recommending and tariff reductions arising from the MTN are two separate, albeit related, matters; the first having as its objective the adjustment of Canadian textile tariffs to levels comparable with our industrialized competitors and the MTN objective being to reduce tariffs in all member countries. Textile tariff reductions agreed to in the GATT should therefore be additional to the tariff reductions the Tribunal is recommending.

CHAPTER IV

TARIFF COMPARISONS

1. Introduction

The terms of reference asked the Tribunal to make recommendations on the reduction of Canada's textile tariffs needed to bring them into line with tariffs on textiles in other industrialized countries, particularly the United States. We were also asked to assess the level of relativity¹ in the structure of Canadian textile tariffs from fibres through to downstream products such as clothing.

To develop a basis for its recommendations, the Tribunal compared Canada's textile tariffs with those of other industrialized countries. The comparison had to be based on a common classification. The newly introduced Harmonized Commodity Description and Coding System (HS) of customs classification provided the framework for this purpose. Even within a common framework, however, comparing tariffs is no simple matter. What countries should be selected for the purposes of comparison? How does the tariff structure of Canada compare with those of other industrialized countries? What methods should be used to assess differences in tariff levels among the countries being compared?

There are some differences in the types of tariff rates applied in different countries. The Tribunal, therefore, had to consider what rates should be used. We also had to decide whether to base comparisons on a line-by-line analysis of tariffs of individual products or on broad averages of tariffs for groups of products or even textile products as a whole. To calculate averages, tariff rates on individual products need to be weighted. After analyzing the structure of the tariff in Canada, and in other countries, and dealing with tariff comparison methods, we then compared actual levels of tariffs.

2. The Harmonized Commodity Description and Coding System (HS) of Customs Classification

No meaningful comparison can be made unless there is a commonly agreed definition of what is being compared. The HS, which is an international commodity description and coding system, provides such a common basis. Most of the world's main trading nations have used the system since 1988, except for the United States which started using it in 1989. All tariffs applied to imports, as well as import and export data, are classified and coded according to the HS.

The HS is divided into several sections designated by roman numerals, which are further subdivided into chapters (two digits), headings (four digits), subheadings (six digits) and tariff items (eight digits). Under the HS convention, the number and definition of subheadings are identical for all countries. In contrast, each country decides on its own number of tariff items according to the variety of products it produces. For Canada, there are 568 tariff items that fall within the scope of this inquiry. The corresponding number of tariff items for the United States, the EEC and Japan are 717, 893, and 762, respectively (i.e., somewhat more than that of Canada), generally reflecting the broader range of products produced by these countries and for which they have created separate tariff rates.

1. Tariff relativity, as formulated in the terms of reference, implies a degree of progressively higher tariff rates on outputs through each phase of the production chain.

The fact that tariffs are set at the eight-digit level, but that international comparability is possible only at the six-digit level, poses some difficulties for tariff comparisons. Within many six-digit subheadings, tariffs at the eight-digit level are the same. In cases where eight-digit tariff items within a six-digit subheading have different rates, however, it is necessary to calculate the average of these rates for comparisons among countries.

Products of almost all the textile and downstream industries are classified under Section XI, Chapters 50 to 63. Chapters 50 to 56 and 58 to 60 include all primary and other textiles; Chapters 61 and 62 cover clothing, and Chapter 63 covers other made-up textile articles such as bed linen. Carpets, handbags, headgear and upholstered furniture and mattresses fall in Chapters 57, 42, 65 and 94, respectively.

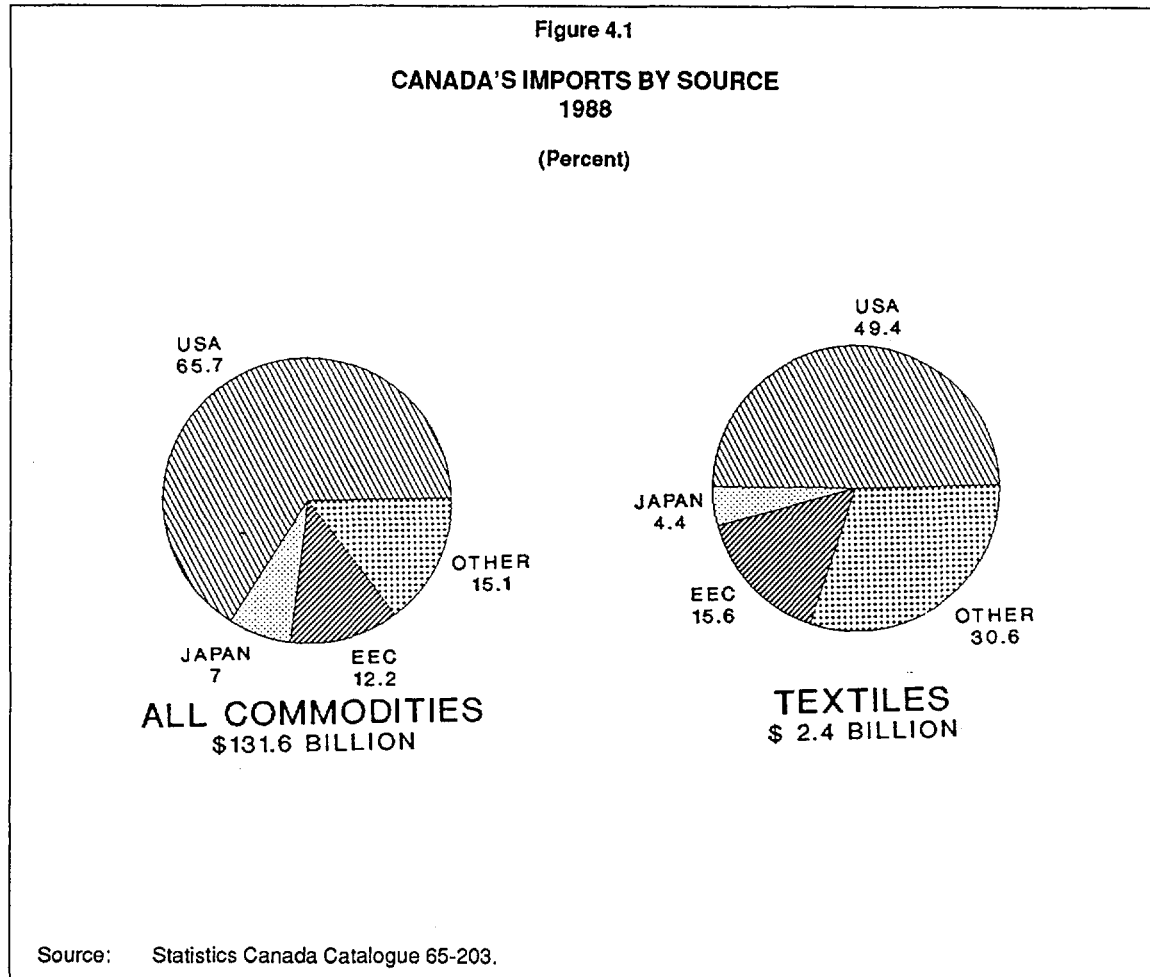
To show how a chapter is subdivided, Table 4.1 sets out a selection of headings, subheadings and tariff items for Chapter 51.

<p style="text-align: center;">Table 4.1</p> <p style="text-align: center;">HARMONIZED SYSTEM (HS) CHAPTER 51 - WOOL, FINE OR COARSE ANIMAL HAIR; HORSEHAIR YARN AND WOVEN FABRIC</p> <p style="text-align: center;">SELECTED HEADINGS, SUBHEADINGS AND TARIFF ITEMS</p>	
HS Number	Description
51.01	Wool, not carded or combed.
	- Greasy, including fleece-washed wool:
5101.11.00	-- Shorn wool
5101.19.00	-- Other
51.08	Yarn of combed wool, not put up for retail sale.
5108.10	- Carded
5108.10.10	--- Containing 50 percent or more by weight of hair
5108.10.20	--- Containing less than 50 percent by weight of hair
51.11	Woven fabrics of carded wool or of carded fine animal hair.
	- Containing 85 percent or more by weight of wool or of fine animal hair:
5111.11	- Of a weight not exceeding 300 g/M ²
5111.11.10	--- In the grey or unfinished condition, of a weight not exceeding 135 g/M ²
5111.11.90	--- Other

3. Comparisons with Other Industrialized Countries

Which of Canada's major industrialized trading partners should serve as a benchmark for comparisons? In considering this question, we looked closely at Canada's trade with its imports from other industrialized countries, particularly from the United States, the EEC and Japan. The CTI had suggested that certain other countries such as Finland, Austria, Australia and South Korea should be taken into account. Although Canada shares some common features with these countries, none of them represents a major source or destination for Canada's trade in textiles or in all commodities.

As can be seen in Figure 4.1, close to 85 percent of Canada's total imports originate in the United States, the EEC and Japan. Moreover, two-thirds of Canada's imports of textiles also come from these three areas. The Tribunal, therefore, decided to compare Canada's textile tariffs with those of the United States, the EEC and Japan, and, because of its preponderant share in Canada's trade, to give more weight to the United States in assessing tariff comparisons.



4. Canada's Textile Tariff Structure and Rates

Before undertaking actual tariff comparisons, we had to understand the Canadian textile tariff structure and the rates applied to various products. We also reviewed the textile tariff structures of Canada's major industrialized trading partners: the United States, the EEC and Japan.

(a) The Tariff Provisions

Canada's tariff provisions are set out in the Canadian *Customs Tariff*. The *Customs Tariff* includes several schedules of which Schedules I and II include provisions affecting textiles. Additional tariff provisions affecting textiles are found in Customs Duties Reduction or Removal Orders.

Schedule I sets out, in two columns, the rates of duty applicable to goods imported under the Most-Favoured-Nation¹ (MFN), and the General Preferential² (GP) tariffs. A very small number of textiles, mainly fibres and yarns, enter at GP tariff rates. Schedule I MFN rates are applied to most, but not all, textile and clothing imports into Canada. Most have been bound, mainly in GATT negotiations. Binding a rate means that a country does not have the right to increase that rate unless it is prepared to offer its trading partners compensating tariff or other trade concessions on other products. Throughout this report, we have referred to these Schedule I rates as "MFN tariffs."

Schedule II, in the Concessionary Annex to the *Customs Tariff*, enumerates a number of statutory end-use items for which there are preferential or concessionary rates. In most cases, they provide for duty-free entry. Other concessionary or preferential end-use provisions are granted on a temporary or renewable basis under Customs Duties Reduction or Removal Orders. In addition, duty remission programs provide for the rebate of duties on imports of selected products, including various categories of textiles and clothing.³ Duty remissions are subject to eligible firms satisfying conditions, usually linked to domestic production.

(b) Concessionary Rates

Many concessionary rates have been in place for several years. They have normally been created for particular products, usually comprising part of an MFN tariff item intended for a particular end use. Most of these are goods which are not made in Canada in the precise specifications required, although the general category of products may be produced domestically. The creation of such provisions has been motivated by a desire to keep input costs low for Canadian industry, where this can be done, without prejudicing the overall protection afforded to domestic production. There are over 200 concessionary textile items enumerated in Schedule II of the *Customs Tariff* and in Customs Duty Reduction or Removal Orders.

As can be observed in Figure 4.2, imports of textiles under concessionary provisions are concentrated in certain product areas, being particularly prominent in the case of man-made fibres and yarns, certain specialty textiles and knitted fabrics. The textile industry is a primary beneficiary of imports under concessionary items, particularly for fibres and yarns. Examples of goods at concessionary rates are unprocessed acrylic staple fibres, for use by various manufacturers, and untwisted partially oriented polyester yarns, for use in the manufacture of texturized yarns, both entering duty-free. Production of both products has been discontinued in Canada. In 1988, total imports were \$16 million and \$17 million, respectively. An example of a product at a concessionary rate for use in downstream industries is nylon fabric for the manufacture of typewriter ribbons. Imports amounted to \$5 million in 1988. There are comparatively few concessionary items for fabrics used in the clothing industry.

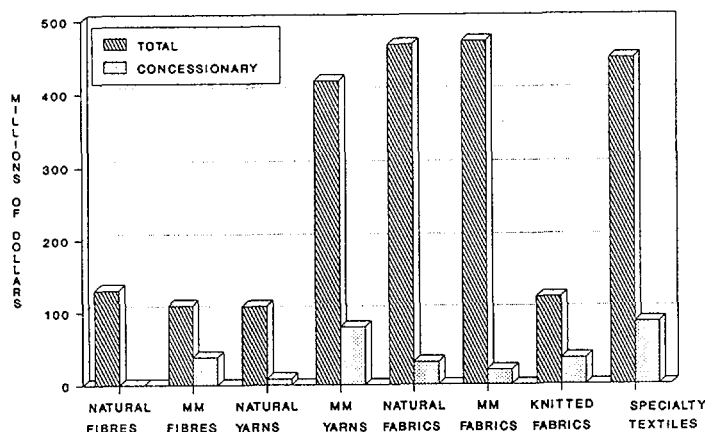
1. The most-favoured-nation principle, as embodied in the GATT, requires a country to apply equal and fair tariff treatment to its trading partners.

2. The general preferential rate applies to imports of certain goods from developing countries. The preference takes the form of a reduced rate or in many cases free entry. Preferential rates are a unilateral tariff concession made by Canada, and other developed countries, in the framework of the General System of Preferences put in place within UNCTAD. These tariff preferences can be withdrawn at any time without incurring obligations towards beneficiary countries.

3. Under a long-standing program relating to shirting fabric, duty remissions have been estimated to range from \$500,000 to \$1 million annually. In his Press Release of March 1988, the Minister of Finance announced the continuation of the shirting fabric program and a shirt program introduced in 1986. New programs for a range of textile and clothing products were introduced in 1989. More details on them can be found in the text of the Minister's Press Release in Volume 2. The maximum amount of annual duty remissions under these programs is estimated to be \$15.5 million for textiles and \$33.8 million for clothing. It is difficult to forecast to what extent these programs will be used. Based on use to date of the shirting fabric and shirt programs, the ceilings for the programs are unlikely to be reached.

Figure 4.2

**CANADA'S TEXTILE IMPORTS
TOTAL AND AT CONCESSIONARY RATES
ALL SOURCES**



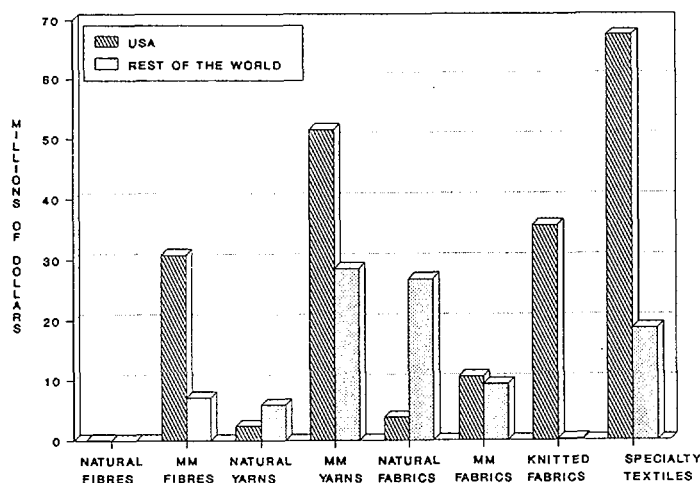
Note: MM = Man-made.

Source: Unpublished Statistics Canada data.

From Figure 4.3, it can be observed that the United States is the primary source of imports of textiles at concessionary rates. In 1988, some 67 percent of the value of goods imported under concessionary items originated in that country. Most man-made fibres and yarns, knitted fabrics and specialty textiles entering under concessionary items are imported from the United States. In contrast, natural yarns and fabrics entering under concessionary provisions come mainly from offshore.

Figure 4.3

**CANADA'S TEXTILE IMPORTS AT
CONCESSIONARY RATES BY SOURCE
USA AND THE REST OF THE WORLD
1988**



Note: MM = Man-made.

Source: Unpublished Statistics Canada data.

(c) Ad Valorem Tariffs and Specific Duties

The overall Canadian tariff structure contains different kinds of duties. The great majority are ad valorem duties expressed as a percentage of import value. There are also some specific duties related to physical measures, e.g., ¢ or \$ per kg. In addition, there are compound duties made up of both an ad valorem component and a specific duty. Finally, some products are subject to either an ad valorem or a specific duty, whichever is the lower. There are now comparatively few specific duties in the Canadian *Customs Tariff*, as the tendency internationally has been to move towards simple ad valorem rates.

Tariffs on most textiles are ad valorem, but there are a number of products subject to compound duties or the lower of an ad valorem or a specific duty. Thus, a compound duty of 10 percent ad valorem plus 11¢ per kg is applied to a range of yarns made from cotton and man-made fibres. Some woollen fabrics, and one specialty textile, are subject to the lower of an ad valorem duty of 25 percent, or \$ 3.45 per kg. For purposes of analysis in this inquiry, any tariff having a specific duty component was converted to an ad valorem equivalent. In relation to the previous examples, this means ad valorem equivalents of approximately 11.5 to 13.0 percent, and 6.0 to 18.0 percent¹ for yarns and woollen fabrics, respectively.

(d) The Structure and Rates of Canadian Textile Tariffs

Average MFN tariffs and the range of tariffs for major product groups are displayed in Table 4.2. Most natural fibres such as wool, cotton, silk and jute enter duty-free. Canadian production of wool is relatively small and vegetable fibres, such as cotton and jute, are not grown in Canada. In contrast, the MFN tariff for nearly all man-made fibre imports, including both filament tow and staple fibres, is 8.5 percent.

Table 4.2 STRUCTURE OF CANADIAN TEXTILE TARIFFS (Percentage)		
Product Group	Average MFN Rate	Range
Fibres: Natural	0.2	0 - 12.5
Man-made	8.3	0 - 8.5
Yarns: Natural	12.3	0 - 12.5
Man-made	12.6	12 - 15
Woven Fabrics: Natural	14.2	0 - 25
Man-made	24.8	22.5 - 25
Knitted Fabrics	25.0	10 - 25
Specialty Textiles	20.3	0 - 25
Sources: Schedule I of the Canadian <i>Customs Tariff</i> . Statistics Canada Catalogue 65-203. 1988 ROW imports.		

1. Schedule I of the *Customs Tariff* stipulates that the average MFN ad valorem equivalent for these fabrics should be 11.8 percent. Accordingly, the specific rate is adjusted annually on the basis of actual imports over the preceding three-year period. See also Volume 2.

Most yarns enter at an MFN rate of 12.5 percent, or the equivalent thereof in the case of compound rates. The only exceptions are silk, which enters free, and vegetable yarns such as jute, which are subject to MFN rates between 0 and 10 percent.

In contrast to yarns, there is a great degree of differentiation of tariff rates for **woven fabrics** by type or blend of fibre. Virtually all fabrics woven with yarns of man-made fibres, including man-made blends, enter at 25 percent.

There is little discernible pattern in rates for other fabrics. Rates for wholly or primarily natural fabrics vary from one fibre to another. In addition, the rates for blends made up of natural and man-made fibres differ by type of natural fibre. Rates on woven woollen fabrics range from 6 percent to 25 percent. Most quality worsted woollens enter under specific duties, their ad valorem equivalents ranging from 10 to 13 percent. Cotton fabrics of a weight by cotton of 85 percent or more enter at an MFN tariff of 15.0 or 17.5 percent, depending on whether they are unbleached or bleached. Thus, a small margin of protection is provided for finishing and dyeing. However, if the cotton content is less than 85 percent, the MFN rates are 22.5 percent and 25.0 percent, respectively, depending on whether the fabrics are unbleached or bleached. Polycotton fabrics are subject to the same rates.

Silk fabrics enter free. Tariffs on fabrics made from other vegetable fibres, such as jute or flax, range from 0 percent to 25 percent, with most imports entering free or at rates much lower than 25 percent.

The MFN rate for all **knitted fabrics**, irrespective of material or type of knit, is 25 percent. For **specialty textiles** such as felts and non-wovens, a broad range of rates apply, most of which are between 20 and 25 percent. A notable exception is tire cord fabrics which enter at a much lower rate of 12.5 percent.

The Canadian MFN structure of tariffs on textiles is thus complex. There is significant differentiation of rates for fibres and fabrics, but not for yarns. The system appears to reflect, at least in part, the strengths and weaknesses of the textile industries when the tariff developed into its current structure many years ago. Textile tariffs have largely escaped reductions negotiated in successive MTNs. In the absence of changes in the MFN tariff structure, special situations have been accommodated largely through concessionary tariff items and duty remission programs.

5. The Structures and Rates of Textile Tariffs in the EEC and Japan¹

As can be seen from Table 4.3, the EEC has a progressive rate structure. All tariffs are ad valorem, and there are no concessionary provisions like those in the Canadian tariff structure. As in Canada, there are few preferential rates on imports of textiles from developing countries. The only tariff concessions are those for duty drawback on exported products made from imported materials on which duty has been paid.

Most natural fibres enter free. The average MFN tariff on man-made fibres is 7.7 percent. The range of rates applicable to yarns runs from 2.9 to 9.5 percent. The 9.5 percent rate applies mainly to man-made yarns. The average MFN rates for cotton and man-made fabrics are 10.1 percent and 10.9 percent, respectively. The MFN rate on woollen fabrics is 17 percent. Specialty textiles have MFN rates in the 5.3 to 15 percent range, the average being 7.2 percent.

1. The tariffs of the EEC and Japan are applied on a CIF valuation basis. If adjusted to an FOB valuation basis used by Canada and the United States, tariffs would be 0.5 to 0.7 percentage points higher, depending on the product.

Table 4.3				
STRUCTURES OF TEXTILE TARIFFS IN THE EEC AND JAPAN				
(Percentage)				
Product Group	Average MFN Rate		Range	
	EEC	Japan	EEC	Japan
Fibres: Natural	0.3	0.3	0 - 3.8	0 - 7.5
Man-made	7.7	7.7	7.5 - 10	4.2 - 8
Yarns: Natural	5.6	5.7	2.9 - 9	3 - 9.6
Man-made	8.9	6.5	3.8 - 9.5	3.9 - 9
Woven Fabrics: Natural	10.1	7.9	3 - 17	4.2 - 11.2
Man-made	10.9	8.4	7.5 - 11	4.8 - 10
Knitted Fabrics	11.8	8.9	6.5 - 12	5.6 - 15.7
Specialty Textiles	7.2	7.2	5.3 - 15	1.5 - 17.9
Note: Tariffs of the EEC and Japan applied on a CIF valuation basis.				
Sources: Tariff schedules of Japan and the EEC. Unpublished Statistics Canada data - 1988 imports.				

Rates for fibres, yarns and fabrics are more clustered than in Canada (i.e., the difference between the lowest and highest rate is smaller). There is less differentiation of rates among similar products especially cotton and man-made fabrics. In this sense, the EEC structure is simpler and more neutral in its economic effects than that of Canada.

Like the EEC, Japan's tariff structure for textiles is progressive from fibres through to fabrics. The general level of rates is, however, lower. There is also similarity to the EEC structure in that there are no concessionary provisions, as is the case with Canada. There are many specific and compound rates, particularly for yarns and fabrics.

As can be seen in Table 4.3, MFN tariffs on imports of fibres range from 0 on most natural fibres to 8 percent on man-made fibres, the average rate for the latter being 7.7 percent. Most yarns are subject to compound rates, the average ad valorem equivalent of which is 5.7 percent for natural yarns and 6.5 percent for man-made yarns. Woven fabrics are subject to ad valorem or compound rates ranging from 4.2 to 11.2 percent. Average rates on natural and man-made woven fabrics are in the same range. As in the EEC, average tariffs for knitted fabric are slightly higher than those for woven fabrics. Average tariffs on specialty textiles are low and similar in level to those of the EEC. Although the Japanese tariff contains many different levels of rates, they fall in narrow clusters for fibres, yarns and fabrics. There is even less differentiation of rates among products, particularly those for woven fabrics, than in the EEC or Canada.

6. The Structure and Rates of Textile Tariffs in the United States

If the EEC and Japanese textile tariffs can be characterized as having relatively concentrated rate structures, and as being less discriminatory among similar products, the US structure resembles that of Canada in the greater dispersion of rates and differential treatment applied to similar products. The structure and levels of US textile tariffs are displayed in Table 4.4.

Table 4.4		
STRUCTURE OF US TEXTILE TARIFFS		
(Percentage)		
Product Group	Average MFN Rate	Range
Fibres: Natural	3.8	0 - 7.4
Man-made	6.5	4.9- 10
Yarns: Natural	7.9	0 - 9
Man-made	10.6	5 - 15
Woven Fabrics: Natural	10.9	3.7- 41.8
Man-made	16.4	7.8- 40
Knitted Fabrics	14.2	8 - 19.5
Specialty Textiles	8.6	0 - 15
Sources: Tariff Schedule of the United States. Import statistics: US Department of Commerce, 1988.		

MFN tariffs on fibres in the United States fall in the 0 to 10 percent range. Unlike Canada, the EEC and Japan, most natural fibres are dutiable. Rates are, however, generally higher for man-made fibres, the average being 6.5 percent. The average MFN tariff on yarns is 7.9 percent for natural yarns and 10.6 percent for man-made yarns. Within these averages, rates range from as low as 0 percent for certain cottons to 13 percent. For yarns such as wool, wool blends, polycotton and man-made yarns, rates range from 9 to 15 percent. The range of MFN rates applicable to fabrics runs from 3.7 percent for light cottons to over 40.0 percent. MFN rates on cotton fabrics fall in the 6 to 15 percent range. Most quality wool fabrics are subject to very high rates, exceeding, for some products, 40 percent. Many man-made fabrics have rates of 17 percent. Rates on knitted fabrics fall in the 8.0 to 19.5 percent range, the average being 14.2 percent. MFN rates on specialty textiles are in the 0 to 15.0 percent range, the average being 8.6 percent.

Thus, US MFN tariffs on textiles are dispersed over a broad range, and average tariffs for certain product groupings can be poor indicators of protection afforded to particular products. The overall structure cannot be characterized as consistent either in terms of rate progression or treatment of similar groups of products, except in the case of man-made fibres. As in Canada, there is relatively little differentiation of rates at the yarn phase of production, but a great degree of differentiation among fabrics.

Like the EEC and Japan, the US tariff structure differs from that of Canada in that there are no concessionary provisions other than normal duty drawbacks. As is the case for Canada and Japan, the US tariff includes many specific and compound rates.

The United States has special outward processing tariff provisions known as Section 807 and Section 807A designed to encourage the use of US materials and components, including textiles. Under Section 807 provisions, clothing made from fabrics cut in the United States can be imported into that country, subject to duty only on the value added by the foreign manufacturer. Approximately 4 percent of US clothing imports enter under these provisions and duty relief is estimated at about \$200 million per year. Section 807A forms part of the *Caribbean Basin Economic Recovery Act*. Under Section 807A, clothing made from US textile fabrics is subject to duty only on the value added abroad. This program also provides for virtually quota-free access.

7. Relativity and Effective Protection

The terms of reference directed the Tribunal to "assess and make recommendations on the level of relativity that should exist in the tariff protection at the various levels of the manufacturing chain (i.e., from fibres and yarns through fabric to finished product)." It also noted that "relativity does not exist in the textile and apparel sectors where, for example, the tariffs on the finished product, apparel, are about the same as the tariff on many of the fabric inputs. Nor does it exist in other sectors which rely on textile inputs; in many cases the tariff on the finished product is actually lower. This tariff structure has placed downstream industries at a competitive disadvantage in the Canadian market against imports of finished products."

Tariff relativity is a difficult concept to grasp. Assessing tariff relativity requires detailed data on production costs and on tariff rates. We will start by explaining our understanding of tariff relativity and then outline our attempts to measure the degree of relativity that exists in the textile and clothing tariff structure.

Tariff relativity as formulated in the terms of reference implies a degree of progressively higher tariff rates as basic materials are transformed at each phase of the production chain. If a tariff is levied on products at the first stage of processing (e.g., fibres), the tariff on products of the next stage (e.g., yarns) should be higher. This higher tariff is needed to allow the manufacturer to overcome the higher cost of fibre inputs and still receive protection on the value added to the fibres through spinning and other processes to manufacture the final product - yarn. This progressivity should continue right through to the downstream product - clothing, carpets or other products manufactured from textiles.

Tariff relativity is measured by calculating the effective rate of tariff protection (ERP) for products throughout the manufacturing chain. It is measured at each phase of the production chain. The ERP takes into account the tariff on purchased inputs, the tariff on the final product and value added at the particular stage of processing. The result is a picture of the amount of protection given by the tariff on a producer's output to the value added by a producer, taking into account the tariff that a producer pays on inputs.¹

The simplified examples set out in Table 4.5 illustrate the steps in the calculation of effective rates of protection for two fabric and clothing products. It shows how a fabric, despite a nominal MFN rate of 25 percent, can receive effective protection 50 percent higher (37.5 percent) than its MFN rate. As well, it illustrates how an article of clothing can have a lower rate of effective protection than the fabric it uses, 25 percent versus 37.5 percent, even though both receive the benefit of the same MFN tariff rate.

Table 4.6 and Figure 4.4 show the ERP at all phases of the textile production chain for products made from man-made and natural fibres, respectively, and for woven and knitted clothing. The effective rates of tariff protection were calculated using data on value added derived from the CITT's survey of the textile and clothing industries.

Under the current tariff structure for textiles and clothing, there are significant differences in the levels of effective protection for certain products. This is particularly the case for clothing made from man-made fabrics. The effective rate of tariff protection of 22.2 percent is much less than the effective rate of tariff protection of 36.9 percent for woven fabrics. Similar differences are observed for knitted clothing and knitted fabrics. Within the textile production chain, natural yarns have a level of effective protection (30.7 percent) which is nearly twice as high as the effective protection on woven fabrics (15.9 percent) or man-made yarns (17.4 percent).

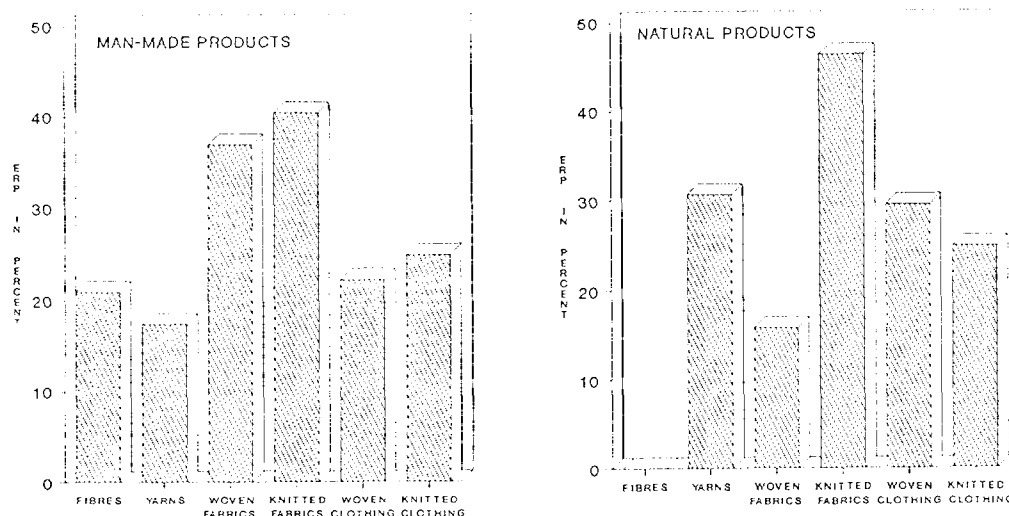
1. See Volume 2 for further discussion of the concept of effective rate of tariff protection and measurement issues.

<p align="center">Table 4.5</p> <p align="center">ILLUSTRATIVE CALCULATION OF EFFECTIVE RATES OF TARIFF PROTECTION (ERP)</p>		
Data and Calculation Steps	Fabric	Clothing
(1) Output Price in Absence of Protection	\$40.00	\$100.00
(2) Tariff on Outputs	25%	25%
(3) Potential Output Price with Protection [(1) X (1 + (2)/100)]	\$50.00	\$125.00
(4) Input Costs in Absence of Protection	\$20.00	\$40.00
(5) Tariff on Inputs	12.5%	25%
(6) Potential Input Costs with Protection [(4) X (1 + (5)/100)]	\$22.50	\$50.00
(7) Potential Value Added with Protection [(3) - (6)]	\$27.50	\$75.00
(8) Value Added in Absence of Protection [(1) - (4)]	\$20.00	\$60.00
(9) Percentage Increase in Value Added as a Result of Tariff Protection = Effective Rate of Tariff Protection (ERP) = 100 X [(7)/(8) - 1]	37.5%	25%

<p align="center">Table 4.6</p> <p align="center">MFN TARIFF RATES AND EFFECTIVE RATES OF TARIFF PROTECTION (ERP)</p> <p align="center">TEXTILES AND CLOTHING, CANADA</p> <p align="center">1988</p> <p align="center">(Percentage)</p>							
		Fibres	Yarns	Woven Fabrics	Knitted Fabrics	Woven Clothing	Knitted Clothing
Man-made Products	MFN Rates ERP	8.3 20.9	12.6 17.4	24.8 36.9	25.0 40.4	23.3 22.2	24.9 24.9
Natural Products	MFN Rates ERP	0.2	12.3 30.7	14.2 15.9	25.0 46.4	23.3 29.5	24.9 24.9
<p>Note: ERP = Effective rates of tariff protection.</p> <p>Sources: Calculation of ERP: Based on data from Schedule I of the Canadian <i>Customs Tariff</i> and CITT survey of the textile and clothing industries.</p>							

Figure 4.4

**EFFECTIVE RATES OF TARIFF PROTECTION (ERP)
TEXTILES AND CLOTHING, CANADA
1988**



Note: ERP = Effective rates of tariff protection.

Sources: Schedule I of the *Canadian Customs Tariff*.
Calculation of effective rates of tariff protection: based on data from CITT survey of the textile and clothing industries.

8. Tariff Comparison Methods

Our review of the structure and types of tariffs applied by Canada, the United States, the EEC and Japan gave us a better understanding of how and to what extent tariff rates differ by type of product. Our next objective was to try to assess the magnitude of the differences in the level of textile tariffs in Canada and other industrialized countries, and particularly in the United States.

Comparing tariffs involves using measures and approaches which provide a common basis for relating Canadian tariffs to those of other countries. We had to decide what approach was the most relevant in terms of developing a basis for our recommendations. Differences in tariffs are easily observed at the level of the individual product, for example, the level of the HS tariff item. However, a line-by-line comparison of the tariff rates on the 568 textile products falling within the scope of our inquiry is not very useful in showing the levels of protection for related product groups. We needed to calculate average tariffs for the major textile product groupings and for all textiles in order to draw conclusions on differences between the level of Canada's textile tariffs and those of our major industrialized trading partners. We also had to bear in mind that averages can mask extreme or unusual factors. Our review of the structure of tariff levels by product told us that there were significant differences in the tariff treatment of certain products of which we would have to take account in the interpretation of average tariff rates.

To calculate average tariffs, it was necessary to select trade weights bearing in mind that, other things being equal, the higher a tariff on a product, the lower the imports of the

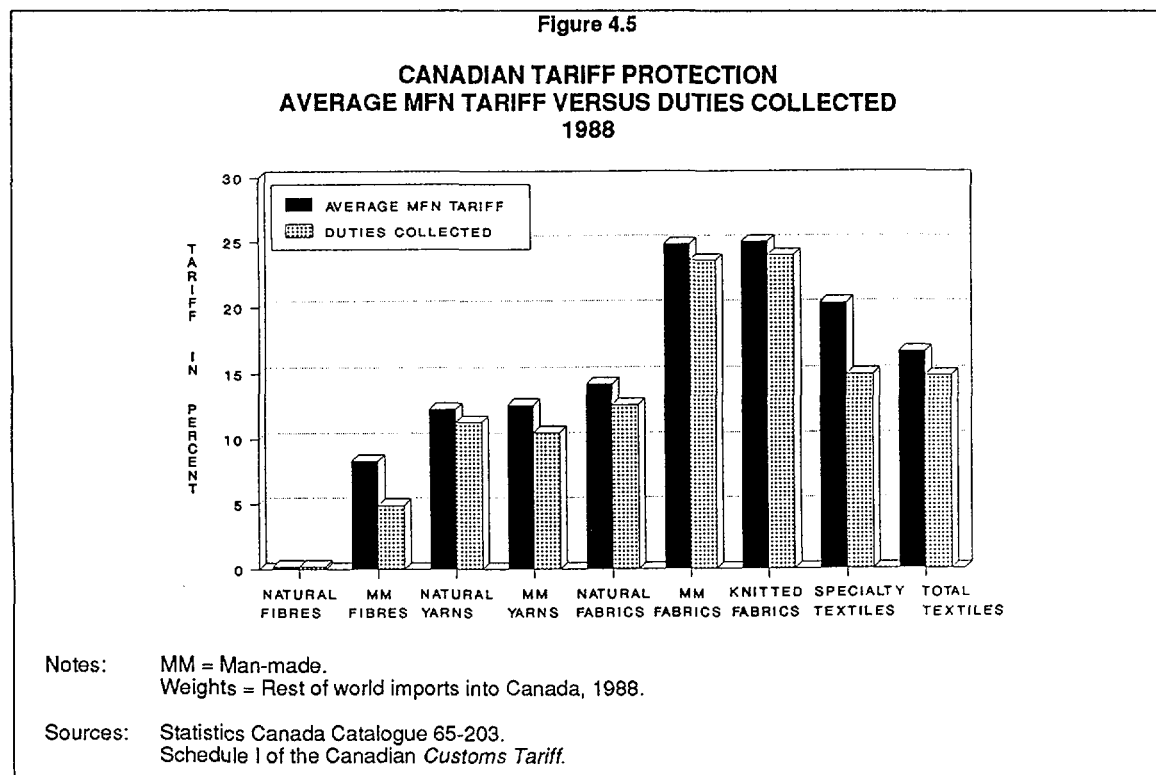
product. The following hypothetical example illustrates the need for weighting. Product X has a tariff of 10 percent and product Y has a rate of 40 percent. The simple average of these two rates is 25 percent. This average would be meaningful if the value of imports at each rate were identical. If, however, imports of product X amounted to \$40 million and those of product Y were \$10 million, the weighted average rate would be 16 percent. We decided to weigh each country's tariff rates by its own imports.

Before proceeding with our analysis and assessment of tariff levels, we addressed two key issues raised in the October hearing concerning methods of comparing tariffs. The first was whether comparisons should be based on MFN rates and, the second, whether we should take account of tariff reductions under the FTA.

(a) Selection of Rates

The obvious common basis for comparisons is the actual Schedule I MFN rates applied to textile products by Canada and the corresponding rates applied by Canada's major trading partners. The CTI argued, however, that account should be taken of the numerous end-use concessionary rates in the Canadian tariff. The CTI proposed that we should calculate average protection by dividing the value of duties collected by the value of total textile imports. Because concessionary rates are lower than MFN rates, the average rate (based on duties collected) is lower than the average MFN rate of protection.

Figure 4.5 compares the averages calculated using both methods. Canada's imports from the rest of the world, excluding those from the United States, were used as weights in the calculations. It is clear that there are differences between average MFN rates and average tariff protection on a duty-collected basis, particularly for certain product groupings such as fibres. For man-made fibres, average duties paid are more than three percentage points lower than the average MFN tariff. For specialty textiles, the difference is over five percentage points, while for all textiles, the difference is less than two percentage points.



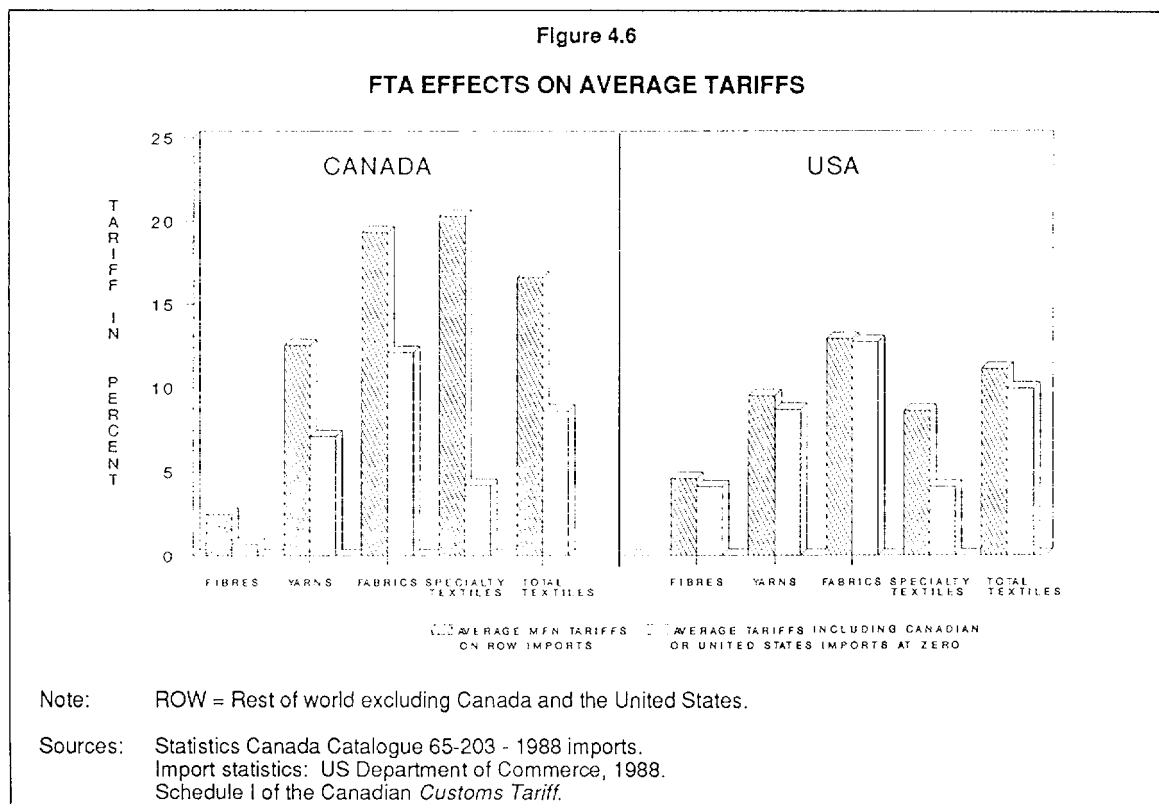
We did not agree with the CTI on the use of average duties collected as a basis for assessing the level of tariff protection in Canada compared to that in other countries. We had two reasons. First, concessionary rates in nearly all cases were created for products that were not made in Canada. Because most of these rates are "unbound," they can be withdrawn without breaching international obligations. In the case of withdrawal, the product in question would be subject once more to the relevant bound MFN rate for that product.

Our second reason for using MFN tariffs was based on our observations of business practice drawn from testimony in our hearings. What counts in the business world is the duty-paid landed price of a particular import as compared to the wholesale price of the same domestic product. If there is no tariff on a product, it will not have an impact on the price of the product. If there is a tariff, it will be the actual rate payable on the product which will be factored into the price and not the average rate of duty paid on imports of similar products of that type. For both these reasons, our comparisons are based on MFN tariff rates.

(b) Should FTA Reductions Be Taken Into Account?

Whether the FTA should be taken into account in average tariff comparisons affects both the choice of rates and import weights. The CTI argued that, in comparing tariffs, it was necessary to take into account the fact that, under the FTA, tariffs on trade in textiles between Canada and the United States would be eliminated by 1998.

The CTI argued that Canada's average tariff on all textile products would be reduced by half once Canadian imports from the United States were duty-free, taking into account that close to half of Canada's textile imports are from the United States. The reduction in average tariffs for the United States would be much less because of the very small share of US imports of textiles which originate in Canada. These effects are displayed in Figure 4.6.



In comparing tariffs, we decided not to take account of imports from the United States. Under the FTA, tariffs on these imports will be reduced to zero by 1998. If US imports were included in our comparison of average textile tariffs, Canada's "average" rates, once the FTA was fully implemented, would be lower than those of most other industrialized countries. At the same time, however, Canada's tariffs on imports of textiles from third countries would remain higher than those of other industrialized countries. This was clearly not the intention underlying the terms of reference, which were sent to us in February 1989 after the FTA began to be implemented. The only reasonable interpretation of the terms of reference is that US imports should be excluded in the calculation of Canada's average MFN tariff rates.

9. Main Findings of Tariff Comparisons

The structure of textile tariffs in Canada differs markedly from those of the EEC and Japan. The latter appear more orderly, with generally less dispersion of rates for the main product groupings of fibres, yarns and fabrics, and less differentiation of rates within groupings of similar products. The US tariff structure is similar to that of Canada in the greater dispersion and differentiation of rates, particularly for fabrics. It differs markedly, however, in the rates applied to products made from different fibres. In the United States, most wool fabrics have high tariffs while the reverse is true in Canada. Rates on cotton fabrics in the United States are low, but high in Canada.

As displayed in Figure 4.7, average MFN tariffs imposed by industrialized countries on textiles are high.¹ In this regard, Canada and the United States stand out not only because their textile tariffs are higher than those of other industrialized countries, but also by the wide margin by which they exceed those on most other products. Average Canadian and US MFN textile tariffs are more than double the average of those applied to all imports.

Figure 4.8 shows how Canadian MFN tariffs on fibres, yarns and fabrics, as well as clothing, compare in a broad international framework. The comparison includes Canada, the United States, the EEC and Japan. In terms of levels, there are large differences in Canada's MFN rates for fibres and yarns as compared to the EEC and Japan, and in fabrics as compared to each of the three areas. The figure also shows a composite rate for the United States, the EEC and Japan based on a 70:20:10 ratio reflecting approximately the structure of Canada's imports of textiles from the three areas.

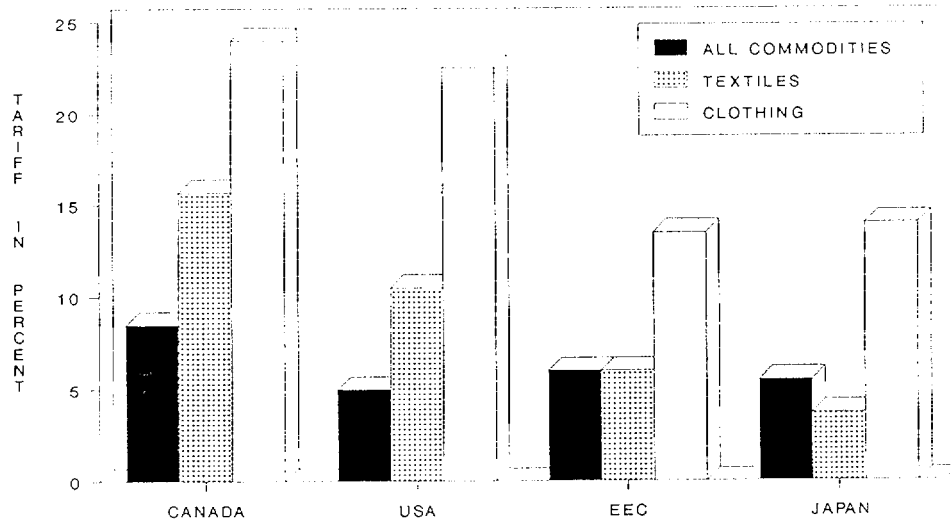
The levels of EEC and Japanese tariffs on fibres, yarns, fabrics, specialty textiles and clothing are, in general, lower than the corresponding rates imposed by Canada and also by the United States.² Moreover, the composite rates for these same product groups are also lower, albeit by a lesser degree, than MFN tariffs for Canada and the United States. Canada's average tariffs on yarns, fabrics and specialty textiles are well above those of the three other areas.

1. The import structures of the EEC and Japan, as distributed among fibres on the one hand, and yarns and fabrics on the other hand, are quite different from those of Canada or the United States. Because the share of fibres in EEC and Japanese imports is much higher, and especially, natural fibres, average tariffs for textiles in the EEC and Japan displayed in Figure 4.7 are relatively low. Comparisons displayed in Figure 4.8 show that tariffs on yarns, and particularly fabrics, are, however, much higher than tariffs on all commodities shown in Figure 4.7.

2. The rates displayed in Figure 4.8 were adjusted to take account of differences in customs valuation, this being on an FOB basis for Canada and the United States, with the EEC and Japan using a CIF system. Adjusting Canadian and US rates to a CIF valuation basis lowered them by 0.5 to 0.7 percentage points depending on the product. The average rates shown were, for the purposes of this comparison, computed by attaching each country's import weights to each HS six-digit tariff line. The actual rates plotted in Figure 4.8 are displayed in Volume 2 of the report.

Figure 4.7

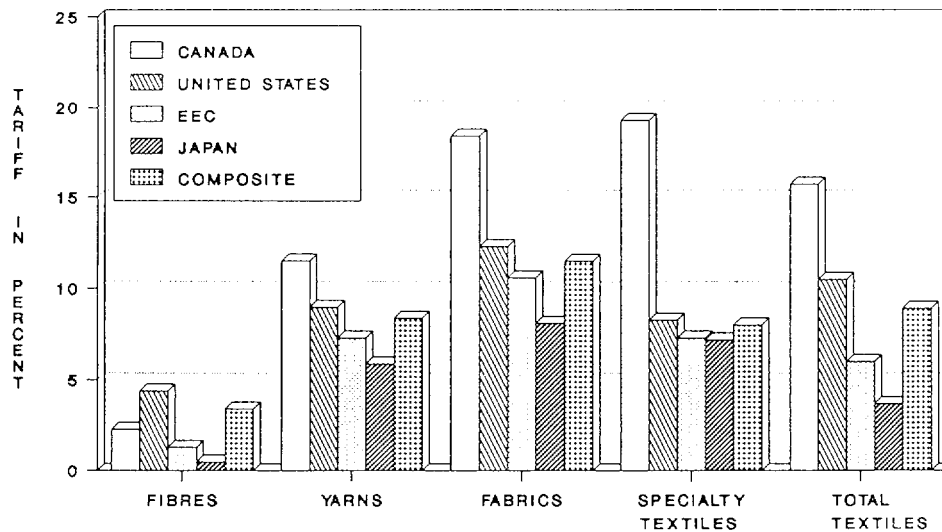
**AVERAGE MFN TARIFFS
TEXTILES, CLOTHING AND ALL COMMODITIES
CANADA, USA, EEC AND JAPAN**



Sources: Tariff schedules and import data, *ibid.* - Canada and US tariffs adjusted from an FOB to a CIF valuation basis.
All commodities: GATT, *Textiles and Clothing in the World Economy*, May 1984.

Figure 4.8

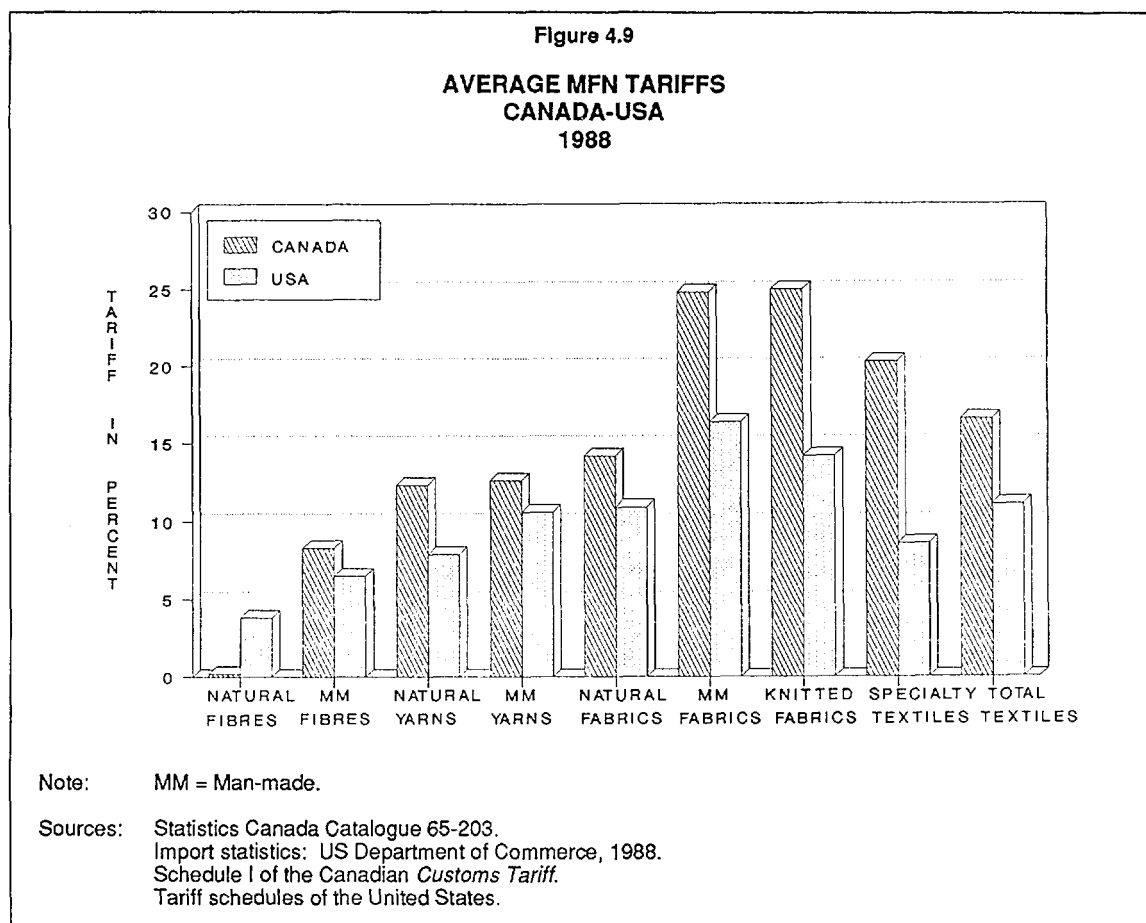
**AVERAGE MFN TARIFFS ON TEXTILES
CANADA, USA, EEC AND JAPAN
1988**



Note: Composite = USA, EEC and Japan in a 70:20:10 ratio.

Sources: Tariff schedules and import data, *op. cit.* Tariffs for Canada and USA adjusted from an FOB to a CIF basis.

The next comparison focuses exclusively on average MFN tariffs on textiles in Canada and the United States. It shows average MFN rates for the 568 HS tariff items that fall within the scope of the inquiry.¹ Average MFN tariffs for eight product groupings and total textile imports are shown in Figure 4.9. Table 4.7 displays the corresponding actual average rates.² The average Canadian MFN rate for textiles in 1988 is 16.6 percent. The corresponding rate for the United States is 11.1 percent.



The higher average Canadian MFN tariff derives mainly from much higher rates for specialty textiles, knitted fabrics and man-made fabrics. The gap between rates on yarns in the two countries is much smaller. For fibres, Canadian average rates are much lower than US rates.

These average results mask particular differences in rates that we observed in our comparison of the textile tariff structures of Canada and the United States. Natural fibres enter Canada free, while man-made fibres face a rate of 8.5 percent. In the United States, most fibres, whether man-made or natural, pay rates in the 3.9-6.5 percent range. In addition, average rates for natural fabrics conceal large differences in tariffs between

1. They include all textile products as defined in Chapter II above with certain exceptions accounting for about \$100 million in imports in 1988, as compared to \$1,140 million of imports entering under the 568 HS tariff items. The full list of products excluded can be found in Volume 2 of this report, but the main product groups are wadding, rope and twine, and floor and wall coverings. These products were not considered to be fibres, yarns or fabrics, nor were they considered to be products used in further processing or manufacturing activities.

2. Averages are calculated using each country's imports from third countries.

<p>Table 4.7</p> <p>AVERAGE MFN TARIFFS</p> <p>CANADA-USA</p> <p>1988⁽¹⁾</p> <p>(Percentage)</p>		
Product Group	Canada	USA
Fibres: Natural	0.2	3.8
Man-made	8.3	6.5
Sub-Total	2.5	4.6
Yarns: Natural	12.3	7.9
Man-made	12.6	10.6
Sub-Total	12.5	9.5
Woven Fabrics: Natural	14.2	10.9
Man-made	24.8	16.4
Sub-Total	19.0	12.9
Knitted Fabrics	25.0	14.2
Specialty Textiles	20.3	8.6
Total Textiles	16.6	11.1
<p>Note: (1) Volume 2 contains a table showing average MFN tariffs calculated using imports from the rest of the world for the first eight months of 1989. There are relatively small differences in average tariffs for some product groups. For total textiles, the Canadian average is 16.3 percent and the US average is 11.1 percent.</p> <p>Sources: Statistics Canada Catalogue 65-203. Schedule I of the Canadian <i>Customs Tariff</i>. Import statistics: US Department of Commerce, 1988. Tariff schedules of the United States.</p>		

Canada and the United States. US tariffs on most wool fabrics are nearly triple those of Canada, whereas Canadian tariffs on cotton fabrics are higher than those of the United States.

As a further illustration of this point, it is also worth observing that, of the 568 tariff items included in the averages shown in Table 4.7, 451 have MFN rates that are higher than those of the United States. Canadian imports from the rest of the world under these items, in 1988, totalled \$850 million.

CHAPTER V

TARIFF REDUCTION OPTIONS DISCUSSED IN PUBLIC HEARINGS

1. Introduction

As part of the process of developing our tariff recommendations, we asked parties to give us their preferences on the structure and level of textile tariffs and on the pace of the tariff reductions. We also sought parties' reactions to methods of analysis and the assessment of the economic effects of tariff reductions.

We had our research staff prepare illustrative tariff reduction options for consideration and comment at the October hearing. The options were developed from tariff comparisons using the methods described in the preceding chapter. In particular, they were based on average MFN tariffs weighted by imports from third countries. Neither average duties paid on total imports nor the trade effects of the FTA were taken into account in assessing the differences in tariff levels between Canada, the United States, the EEC and Japan.

The staff options brought Canadian tariffs close to the levels of the United States and other industrialized countries. To reach US textile tariff levels would mean average MFN tariff reductions of about one-third; even greater reductions would be needed to approach the tariff levels of our major trading partners.

The options presented to parties also provided for different phasing in periods for the reductions. Three alternative time frames were developed, not only to obtain parties' reactions on how quickly or slowly reductions should occur, but also as part of the assessment of economic effects and benefits and costs.

We engaged consultants to carry out the economic assessments. Informetrica Limited conducted an econometric study of the effects of tariff reductions on prices, output and employment. Abt Associates of Canada analyzed the benefits and costs of tariff reductions. Professor Tim Hazledine provided overall advice and quality control. The studies were presented at the October hearing for examination by parties in respect of both the assessment results and the methods used.

2. Illustrative Tariff Reduction Options

Several different approaches for reducing tariffs on textiles were considered at the October hearing. Parties focused their attention on two basic options which the Tribunal staff presented for illustrative purposes only.

Option A was developed using a line-by-line comparison of Canadian and US tariffs. Under this option, Canadian tariffs on textile products that were higher than their US equivalents would be reduced to US levels. Such an option would reduce the average of Canadian MFN tariffs by one-third. Option A would result in a Canadian average MFN tariff slightly below that of the United States. The resulting structure would, with the exception of tariffs for natural fibres and woollen fabrics, mirror closely that of the United States. Reductions for some tariff items would be large, exceeding 50 percent.

Option B was based on two different considerations. The first was to introduce into the tariff structure a basic gradation in rates applicable to all similar products. This would address the Minister's request that the Tribunal pay attention to the level of effective protection throughout the manufacturing chain from fibres through to finished clothing.

In establishing tariff levels for Option B, the research staff selected rates which approximated average MFN tariffs not only in the United States, but also in the EEC and Japan. The composite average of MFN tariffs for basic textile product groups in the United States, the EEC and Japan provided a benchmark for selecting the level of tariffs.

This second option resulted in a simple tariff structure option in which fibres, yarns and fabrics would be subject to maximum tariffs of 5, 9 and 13 percent, respectively. The 13 percent maximum rate for fabrics would also apply to specialty textiles. The effect of applying this simple tariff structure would be to reduce average Canadian MFN tariffs by about 36 percent. Most Canadian tariffs would fall below those of the United States.

Table 5.1 compares how Options A and B would affect average MFN tariffs for the main groups of textile products.

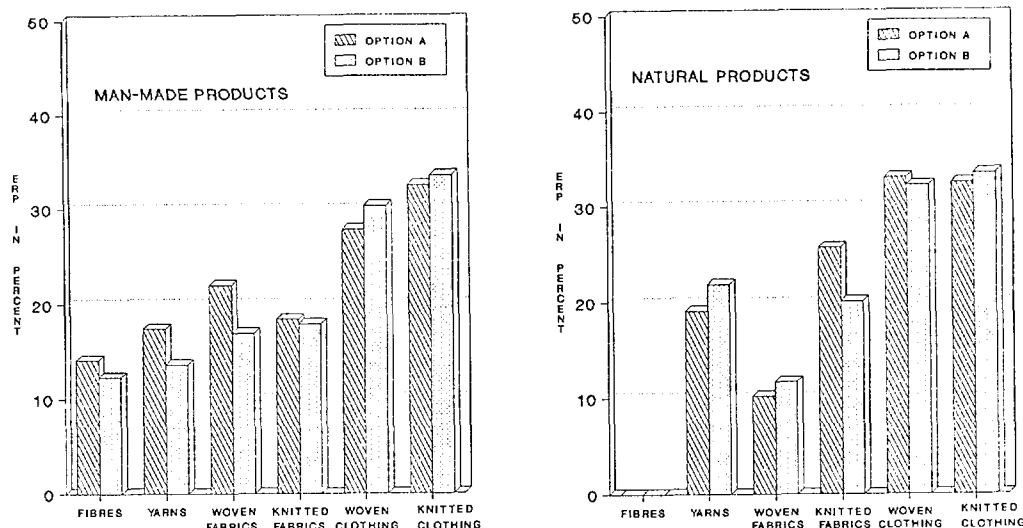
<p style="text-align: center;">Table 5.1</p> <p style="text-align: center;">ILLUSTRATIVE TARIFF REDUCTION OPTIONS</p> <p style="text-align: center;">(Percentage)</p>				
Product Group	Current Canadian Tariff	Option A: Lower of Canadian or US Tariff	Option B: Simple Tariff Structure (5-9-13)	US Tariff
Fibres: Natural	0.2	0.1	0.1	3.8
Man-made	8.3	5.6	4.9	6.5
Sub-Total	2.5	1.7	1.5	4.6
Yarns: Natural	12.3	7.7	8.8	7.9
Man-made	12.6	11.2	9.0	10.6
Sub-Total	12.5	10.2	8.9	9.5
Fabrics: Natural	14.2	9.0	10.4	10.9
Man-made	24.8	16.7	13.0	16.4
Sub-Total	19.0	12.5	11.6	12.9
Knitted Fabrics	25.0	14.4	13.0	14.2
Specialty Textiles	20.3	7.5	12.0	8.6
Total Textiles	16.6	11.0	10.3	11.1
<p>Notes: Current average MFN Canadian and US tariffs are taken from Table 4.7. Rates shown for Options A and B are weighted averages of rates that would apply to individual tariff items under Options A and B.</p>				

Figure 5.1 shows the effect that each option would have on the rates of effective tariff protection within the textile production chain and in the clothing industry. The simple structure would result in a more consistent pattern of effective protection through the production chain, except for natural yarns.

Three different implementation periods were considered at the October hearing. The first provided for the full reduction of tariffs on textiles on April 1, 1990. Under the second approach, tariffs would be reduced in 10 equal annual instalments starting on April 1, 1990. The third scheme was back-end loaded, with no tariff reductions before April 1, 1994, and, from then on, reductions in five equal annual instalments.

Figure 5.1

**EFFECTIVE RATES OF TARIFF PROTECTION (ERP)
TEXTILES AND CLOTHING
ILLUSTRATIVE TARIFF REDUCTION OPTIONS**



Note: ERP = Effective rates of tariff protection.

Sources: Canadian Customs Tariff and CITT survey.

3. Parties' Reaction to the Illustrative Tariff Reduction Options

At the October hearing, parties commented extensively on both the level and pace of the tariff reduction options.

The CTI continued to challenge the need for any tariff reductions at all. It argued that there was no analytical basis for concluding that Canadian textile tariffs were higher than those of other industrialized countries, particularly the United States. Its comments on the illustrative tariff reduction options focused mainly on Option A, under which a Canadian tariff would be replaced by a US tariff, if the latter were lower than the corresponding tariff in Canada. The CTI stressed that this approach would reduce the average Canadian textile tariff below that of the United States. It also observed that following this approach would be tantamount to replacing the structure of the Canadian textile tariff with that of the United States. For instance, counsel for Dominion Textile Inc. observed that the US structure provides differentiation of tariffs for products such as light and heavy cotton fabrics. This kind of differentiation, which does not now exist in the Canadian tariff structure, would be detrimental to the Canadian industry.

The clothing industry expressed a general preference for Option B. The textile industry observed that the tariff reductions implied by Option B were even greater than those under Option A.

In terms of timing, the clothing industry's preference was for an immediate reduction of tariffs on textiles, although it was prepared to consider implementation over a period of

up to five years. The textile industry, while continuing to oppose any tariff reductions, strongly expressed the view that, if there were to be reductions, they should be delayed for as long a period as possible. In this regard, it observed that the "back-end loaded" option, which would concentrate reductions in the second half of the 1990s, would allow the industry more time to adjust to FTA reductions and would also allow it to take into account MTN tariff reductions and any relaxation of the MFA.

4. Economic Assessment

(a) Estimation of the Impact on Prices, Output and Employment

A reduction in tariffs for textiles would lead to a series of pricing, purchasing and production responses. Changes would occur throughout the textile chain, beginning with producers of textiles and ending with the consumer of final products containing textiles.

The economic analysis carried out by our staff and consultants was intended to help us gauge the reactions of the Canadian textile and downstream industries and consumers to textile tariff reductions. We expected that it would shed light on the following questions of interest to the inquiry:

- To what extent would Canadian textile manufacturers lower their prices and reduce their costs to maintain market share and profit margins?
- To what extent would the reduction in textile tariffs lead to lower costs for "downstream" industries which manufacture products such as clothing and furniture?
- To what extent would the tariff reductions lead to price reductions for the consumer at the retail level?
- How would price and supply changes affect the employment, profitability and competitive position of textile manufacturers?
- What would be the distribution of overall benefits and costs to the Canadian economy and textile producing regions?

(b) Results

In order to assess the economic impact of a reduction in textile tariffs, two different models were developed and used. First, a 10-industry econometric model¹ was built using annual historical data for the period from 1961 to 1985. Second, a benefit-cost model² was developed to assess the benefits and costs likely to arise from any assumed tariff reduction.

The two models were used to estimate the economic effects of the two illustrative tariff reduction options described earlier in this chapter. The estimated economic effect of a tariff reduction is calculated as the difference between the model's projection with and without a tariff cut (i.e., the base case). This approach directly estimates the effects of a tariff reduction, holding all other factors constant. In this process, the particular characteristics of the base case do not affect the estimated effects of the tariff option. The model results

1. Informetrica Limited, The Impact of Tariff Reductions on the Textile and Downstream Industries: An Econometric Study, prepared for the CITT, September 1989.

2. Abt Associates of Canada, An Assessment of the Benefits and Costs of Tariff Reductions in the Canadian Textile Industry, October 1989.

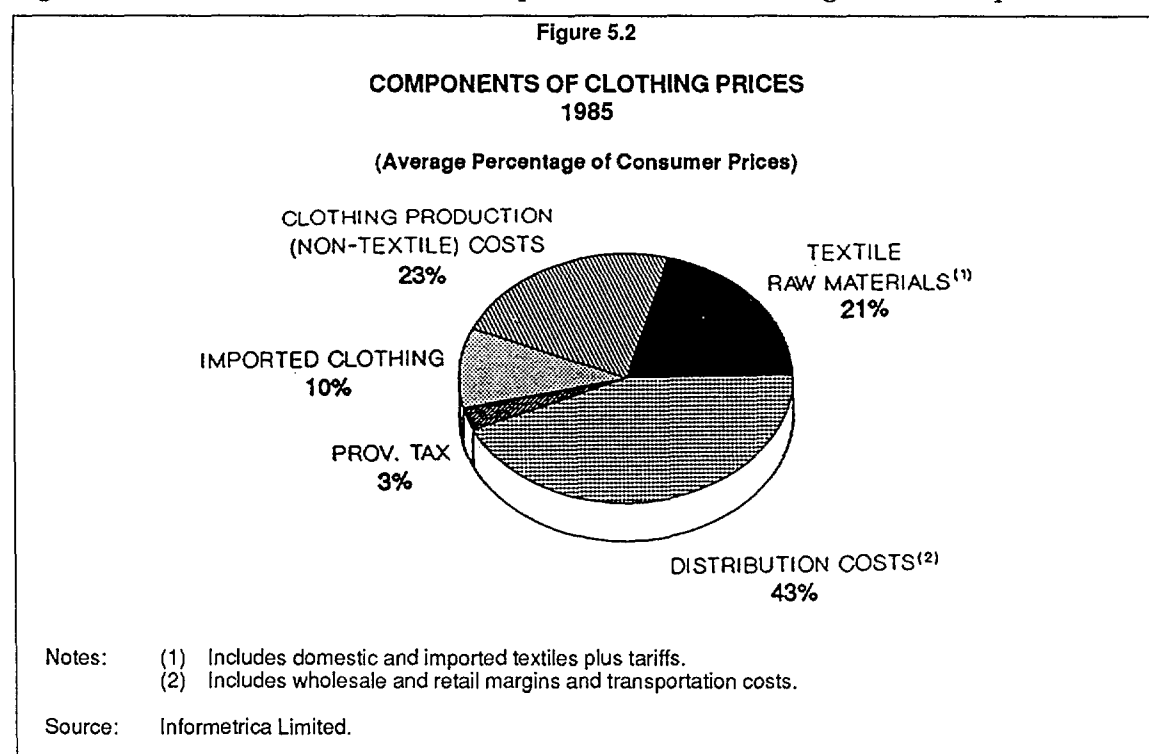
for output, employment and selling prices for three industry groupings are shown in Table 5.2.

Table 5.2						
COMPARISON OF CUMULATIVE ECONOMIC CHANGES BY YEAR 2000 FOR ILLUSTRATIVE TARIFF REDUCTION OPTIONS						
	(Percent Difference from Base Case)					
	Output		Employment		Prices	
	A	B	A	B	A	B
Textile Industry	-1.9	-2.4	-2.2	-2.8	-0.6	-0.8
Clothing Industry	0.1	0.2	0.1	0.2	-0.2	-0.2
Other Downstream Industries	0.1	0.1	0.1	0.1	-0.0	-0.1

Notes: (1) Option A is a reduction in MFN textile tariff on imports from the rest of the world by an average of 33 percent.
 (2) Option B is a reduction in MFN textile tariff on imports from the rest of the world by an average of 36 percent.
 (3) In both cases, the reductions are phased in over a 10-year period beginning in 1990.
 (4) Economic change is the difference between the two-model projections, one with and one without a tariff reduction.

Source: Informetrica Limited.

In terms of specific effects, the price changes appear relatively small compared to the magnitude of the proposed changes in tariff rates. In general, this easing of the transmission of the size of the tariff cut is due to the small relative shares, of both domestic and imported textile materials, in the final price of many products made from textiles. The major components of a dollar spent by the consumer on clothing, for example, are set out in Figure 5.2. The cost of domestic and imported textiles, including the tariff, represented on



average roughly 20 cents of each dollar spent in 1985 on clothing by the consumer. The tariff itself accounts for less than one-tenth of one percent.

On the output side, the decrease for the textile industry is significantly greater than the increase in output for the clothing and other downstream industries. The major reasons for this divergence are the differences in the size of the price reductions facing buyers of primary textiles and buyers of final consumer goods, and the differences in price sensitivity in each market. Both the size of the price reduction and the sensitivity of demand to changes in price appear to be larger for the textile industries than for the clothing and other downstream industries.

(i) Views of Industry

Counsel for the textile industry criticized the econometric model because of structural omissions and limitations in what the model is capable of predicting. Their main criticism was the omission of investment from the econometric model and, in particular, the inability of the model to indicate the departure of textile producers from the industry, or at least from production in Canada in response to the tariff reductions. A second general criticism was the use of historical data to predict changes in a future period which will be substantially different from the past.

(ii) Views of Tribunal

Some of the textile industry's observations about the limitations of econometric models are valid. However, we consider reasonable the model's simulation of the effects of tariff reductions on demand and prices. Investment is admittedly difficult to model because it does tend to be "lumpy" and subject to confidence factors. But the investment climate is likely to be determined by a variety of business and government factors - not simply tariff changes. It seems reasonable to expect that investment by the textile industry would continue to be on an upward trend through the period, though the marginally slower growth in the textile industry caused by the tariff reduction would probably cause investment to increase at a slower rate than if tariffs were not reduced.

The Tribunal observes that econometric models normally make use of historical data to estimate future behaviour and that they usually work well, provided unexpected events do not cause a major structural break in patterns of behaviour. Such abrupt changes in behaviour are unlikely to occur in response to the relatively modest tariff reductions modelled, particularly when they are phased in over several years.

Despite the criticisms put forward, the Tribunal concluded that the model provided estimates which were a reasonable guide to the direction and magnitude of change for output, employment and prices resulting from the illustrative tariff options.

(c) Benefits and Costs

The benefit-cost framework developed for the CITT by Abt Associates of Canada was used to assess the separate components of the benefits and costs flowing from an assumed set of reductions in textile tariffs. The estimates of elasticities, prices, demand and the changes in employment provided by the Informetrica Limited econometric model are key inputs in the evaluation of benefits and costs.

The benefits included in this assessment are the gains to consumers from lower prices, less the net change in any "above normal" returns to capital in the textile and downstream industries, less the net loss in government tariff revenues. A range of benefits was estimated using three different assumptions for the pricing response of domestic industry to lower textile tariffs.

The costs included in this assessment are the net adjustment costs for workers, arising from the lower level of employment in the industries directly affected by the lower tariff levels. Historical data on employment mobility within and out of the textile industry were used to develop assumptions on the speed of re-employment of textile workers in Ontario and Quebec. A rapid rate of employment adjustment for Ontario and a slower rate of employment adjustment for Quebec was assumed. Over 90 percent of total industry employment is located in these two provinces. The costs were calculated on a private (per worker) basis and on a social (including all segments of the economy) basis.

The entire stream of future benefits and costs was expressed as a single "present value" through the use of a discount rate, normally referred to as the social opportunity cost of capital. A discount rate of 7.5 percent real (i.e., after removing the effects of inflation) was assumed, consistent with standard practice in the field of benefit-cost analysis. The estimates for the 10-year implementation of the two illustrative tariff options are shown in Table 5.3. In both cases, the benefits are significantly greater than the costs.

<p>Table 5.3</p> <p>NET BENEFITS FOR ILLUSTRATIVE TARIFF REDUCTIONS</p> <p>(Millions of 1989 Dollars)</p>		
	Option A	Option B
Consumer Gain on ROW Imports	308.3	391.6
Lost Tariff Revenue on ROW Imports	-218.9	-282.8
Lost Tariff Revenue on US Imports	-5.4	-6.6
Net Welfare Gains	84.0	102.2
Social Adjustment Costs	6.0	7.4
Net Benefits with No Domestic Price Response	78.0	94.8
Addendum:		
Net Benefits with Domestic Price Response		
(i) Reduced Profits	52.8	61.8
(ii) Cost-saving	276.1	350.1
<p>Notes: (1) Option A is a reduction in average MFN textile tariff rates on imports from the rest of the world by an average of 33 percent.</p> <p>(2) Option B is a reduction in average MFN textile tariff rates on imports from the rest of the world by an average of 36 percent.</p> <p>(3) For both options, the reductions are assumed to be phased in over a 10-year time period beginning in 1990.</p> <p>(4) Net benefits are the net present values for the period from 1990 to 2005.</p> <p>(5) The estimates for the components of net benefits for the cases with a domestic price response are not provided in the table.</p> <p>ROW = Rest of world excluding Canada and the United States.</p> <p>Source: Abt Associates of Canada.</p>		

(I) Views of Industry

Counsel for the textile industry criticized the benefit-cost framework for under-estimating the costs and overestimating the benefits likely to arise from a reduction in textile tariffs. In terms of the estimate of costs, they argued that the data on employee mobility

(turnover rates) were outdated and drawn from a period when the recession at the beginning of the 1980s was likely to have biased the rates upwards. A second major criticism was that the methodology was too narrow in its measure of costs arising from unemployment: it did not include the effect of the loss of non-wage employee benefits, the increase in mental stress and anguish, and the effect of rising unemployment on specific communities, particularly small towns. A third criticism was the initial failure to estimate the differing provincial costs arising from the tariff reductions. On the benefit side, they argued that the assumption that the textile industry will find ways to rationalize its production process was overly optimistic. Furthermore, textile industry representatives argued that there would be very small benefits arising from the tariff reductions, due to the combination of a small decrease in clothing prices for the consumer and consumers' relatively low sensitivity to price for clothing.

(ii) Views of Tribunal

Despite the arguments presented by the textile industry, the Tribunal considers that the methodology provides a useful indication of the relative importance of the benefits and costs likely to arise from lower textile tariffs. For the cost estimates, the historical record supports the use of at least an average manufacturing labour turnover rate for the textile industry, notwithstanding the lack of availability of current data. The methodology could have been improved, however, by the inclusion of an estimate of the non-wage losses for individuals and communities arising from lower employment.

The arguments against the methodology on the benefits side were less persuasive. The study did include one more optimistic assumption involving the generation of cost-savings in the production process as a result of tariff reductions, though this was not the main case presented at the hearings. While it may be too optimistic to assume that all tariff reductions would be matched by textile industry cost reductions, it would be unduly pessimistic to assume that no cost reductions are possible. In addition, though there may be only a small decrease in consumer prices for individual items, the aggregation of these benefits amounts to a significant gain for the country as a whole.

CHAPTER VI

RECOMMENDED TARIFF REDUCTIONS

1. Introduction

In this chapter, we set out our recommendations on the size, timing and pace of reductions in Canada's textile tariffs. We also consider the question of whether any products should be exempted from the tariff reductions. Finally, we review a number of specific product requests submitted to the Tribunal for tariff acceleration or elimination.

We have reflected on the testimony gathered at the June and October hearings and on the research that was carried out by our staff and consultants. The October hearing helped clarify our thinking on how to measure differences in tariffs among countries. That hearing also influenced our view of the illustrative tariff reduction options that the research staff had prepared.

We have carefully examined what was said and considered alternative approaches that would meet the main concerns presented in October with respect to the structure of tariffs, the level of rates and the pace of implementation.

2. Tariff Rates and Structure

(a) Our Recommendations

The Tribunal proposes that Canada move towards a simpler textile tariff structure involving maximum tariffs for fibres, yarns and fabrics:

- | | |
|------------------------------|------------|
| • fibres | 5 percent |
| • yarns | 10 percent |
| • fabrics, woven and knitted | 16 percent |

For all **specialty textiles**, we propose that current rates be reduced by **one-third**.

The application of this simpler structure would reduce tariffs on most natural and man-made textile products, including knitted fabrics. Use of this structure would result in the reduction of rates on about 451 HS tariff items. Rates on 117 other items, including most fabrics made with natural fibres, would not change. For specialty textiles, the one-third reduction we are proposing is close to, but not as great as, that applied to most fabrics. The line-by-line recommendations for Schedule I MFN HS tariff items are listed in Volume 2.

(b) Rationale

Comparisons of tariffs on textiles have confirmed that Canadian MFN textile tariffs are generally much higher than those of the United States, the EEC and Japan. Simple comparisons of the structure and levels of tariffs have not, however, provided a sufficiently precise model for adjusting tariffs. EEC and Japanese tariffs on textiles are more consistently structured than those of the United States or Canada. There is a relatively smaller dispersion of rates within each of the three

main phases of the textile production chain, and there is a pattern of rate progression from fibres to fabrics. Each, however, has some anomalies. For example, there are relatively high tariffs on wool fabrics in the EEC and many compound rates in Japan.

The US tariff structure would also not be a good model. It has major anomalies which, for many products, are different from those found in the Canadian tariff structure. We agree with the CTI about the risks of importing the US tariff structure into Canada. We also agree with the CTI that, in setting a new level of textile tariffs in Canada, it is reasonable to put more weight on overall average tariffs in the United States. The United States is Canada's major trading partner. Competition in the North American market in the coming years will be a decisive factor in the development of the Canadian textile industries and of the downstream industries using textiles. However, taking account of average US textile tariffs cannot be taken to mean that tariffs on certain textile products should not fall below those of the United States. Nor should it mean that all Canadian tariffs exceeding those of the United States must be reduced. To accept such a premise would make it difficult to develop a structure of textile tariffs that is more suitable to Canadian circumstances.

If the structures of the US, the EEC and Japanese textile tariffs do not provide suitable models, neither does the existing Canadian structure. It has many anomalies which lead to similar or substitutable products being treated quite differently. The structure of Canada's textile tariffs is particularly complex. We were not told, and our own review of Canadian tariffs on textiles has not informed us, why or how they developed into their present structure. There is a great variety of rates for similar products, particularly fibres and fabrics. In contrast, most yarns have similar tariff rates. The present structure also includes specific and compound duties. It is also characterized by uneven levels of relative protection among the main stages of textile production and between the textile industry and downstream industries. For these reasons, we have rejected a proportionate reduction in existing rates which would only replicate today's textile tariff structure.

Our review of other factors, and particularly the comparison of VERs in Canada and the United States, has influenced our recommendations. Measurement of the effect and scope of VERs is very difficult. Beyond the measurement problem, there is no agreed method for equating the trade effects of VERs to those of a tariff. In addition, VERs are a far less permanent feature of the international trading regime than are tariffs. The MFA has been renewed at four- to five-year intervals and it is easier to negotiate bilaterally the introduction or a significant amendment of particular VERs. Tariffs, on the other hand, are a much more stable feature of the trading regime as part of the GATT. Nonetheless, the VER system of the United States is more comprehensive, probably reflecting the greater range of domestically manufactured products and broader sources of imports. The US system may also be more tightly negotiated and administered, reflecting that country's bargaining power. Taking account of these perceptions, we have reduced somewhat the size of our recommended tariff reductions, relative to what would have been indicated by a strict comparison between average Canadian and US MFN textile tariff rates.

We believe that the structure of Canadian textile tariffs needs reform. The current welter of rates should be replaced, to the extent possible, by a simple, progressive rate structure covering all fibres, yarns and fabrics.

There were a number of factors that brought us to the conclusion that imports of similar textile products should be subject to the same maximum tariff rates. Whatever were the rationales of the current Canadian textile tariff structure and

that of the United States, they have been overtaken by developments in technology and in the market. The structure of Canadian tariff rates, as it now stands, creates artificial distinctions, particularly between woven natural fabrics and blended fabrics. A small difference in fibre content can mean a large difference in tariff protection (e.g., the tariffs on blended cotton fabrics can be 17.5 percent or 25.0 percent, for a change in fibre content of one percentage point). There are no such distinctions for tariffs on the yarns used to weave these fabrics.

The world textile industry produces a far greater number of products today than many years ago. New products and new markets have developed, particularly for industrial uses. In clothing and home furnishings markets, demand for a particular textile is subject to the dictates of style and fashion. Even common products, such as denim and corduroy, can go out of style for periods of time leading to stop-and-go production decisions.

Most fibres, yarns and fabrics are increasingly in competition with one another. Why should different tariff rates be applied to roughly similar products and particularly fibres and fabrics, bearing in mind the impact different tariff rates have on what or how much should be produced? Even if we thought a case could have been made for treating products differently, there is little hard information available to provide the basis on which it should be done, and no assurance that the reason for differentiating rates would hold true in the future.

Thus, we think that attempting to "fine tune" the tariff to take account of the situation in the market for particular products at a particular point in time could lead to distortions in the use of resources. In other words, the tariff should be neutral among similar products. In this respect, the current structure of tariffs on textiles differs from that for other products to the extent to which it distinguishes between similar products made from different materials. We believe a single rate should apply to similar products whatever the technical characteristics, the materials used or the price of a particular product.

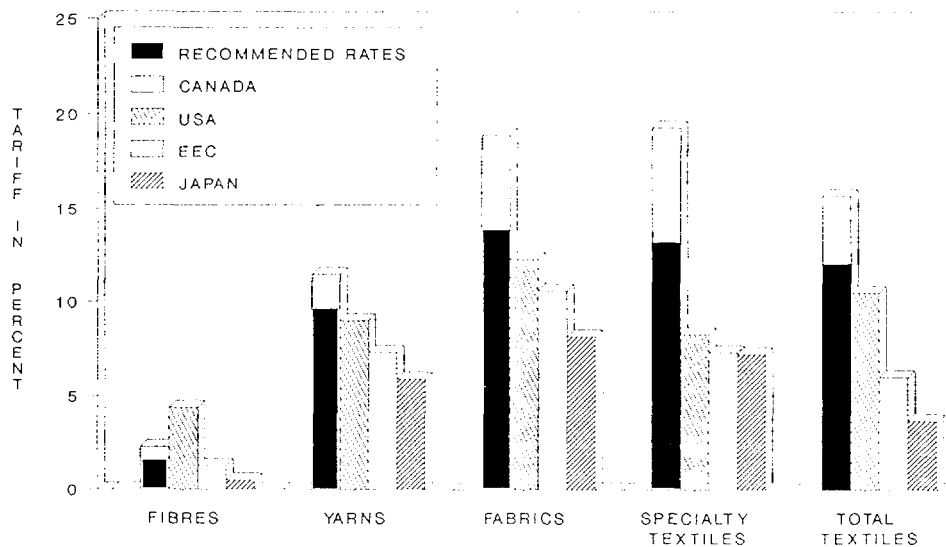
We also rejected industry suggestions that we take into account production costs and macro economic factors, such as exchange rates and interest rates in setting tariffs. In contrast to the long-term nature of a tariff, production costs and economic factors generally shift over time in response to a broad range of influences, sometimes in an interdependent fashion.

Having concluded that a neutral tariff structure would be best suited for textile products, we addressed the question of what the level of rates should be for fibres, yarns and fabrics. There were a number of considerations. One was to develop a structure of rates that approximated those of our major industrialized trading partners, and the United States in particular. Another consideration was to take account of the differences in the overall level of tariffs on textile products in Canada as compared to the other three areas, as well as the perceived effects of a tighter VER regime in the United States. We also took account of the FTA-related adjustments already facing the textile industry and of the prospect of further textile tariff reductions in the MTN.

We concluded that, in the context of a simpler tariff structure, maximum rates of 5, 10 and 16 percent for fibres, yarns and fabrics, respectively, would reflect these considerations. As can be seen from Figure 6.1, this simpler structure of maximum tariffs results in average rates that are somewhat higher than those of the

Figure 6.1

**TRIBUNAL TARIFF RECOMMENDATIONS
AVERAGE MFN TARIFFS
CANADA, USA, EEC AND JAPAN**



Sources: Tariff schedules for Canada and USA adjusted from an FOB to a CIF basis.
Tariff schedules of Japan and the EEC.
Tribunal tariff recommendations adjusted from an FOB to a CIF basis.

United States, and higher still than those of the EEC or Japan.¹ Average rates on fibres approach those of the EEC and Japan. Average rates for yarns move down to those of the United States, but remain somewhat above those of the EEC and Japan. Average rates for fabrics come down towards, but still remain above, those of the United States.

This structure would reduce rates on most fibres, yarns and fabrics imported into Canada from the rest of the world. The main exceptions would be tariffs on woven natural fabrics. For example, tariffs on most woollen fabrics would not change, while tariffs on some cotton fabrics would be reduced only marginally. This would result in a significant change in the relative level of MFN protection among fabrics. Reduced tariffs on knitted fabrics and on woven man-made fabrics will narrow significantly the large gap in rates that now exists.

We also looked at what effect this simpler structure would have on effective rates of tariff protection in the textile production chain. Over most phases, the dispersion of effective rates of tariff protection is reduced. Within primary textiles, however, effective protection for natural yarns, while reduced, still remains high compared to that for man-made yarns.

1. As noted in Chapter IV, the relatively low average tariffs on textiles for the EEC and Japan reflect the effects of a high proportion of fibres in total textile imports.

We considered a variation on this 5-10-16 structure with a lower maximum rate for natural yarns and fabrics. In this modified system, reductions in tariffs on natural yarns would be greater than those on man-made yarns. Tariffs on woven natural fabrics would also be reduced marginally more under the simple structure, but by less in absolute terms than for other fabrics.

We rejected this variation for two reasons. The first was that we realized that, by giving too much emphasis to the need to fine tune effective protection at each phase of the production chain, the result would be a nominal MFN structure that would perpetuate the artificial distinction in tariffs between products made from natural and man-made fibres. In addition, effective protection varies significantly from one manufacturer to another depending on costs and what is produced. On balance, we believe our simpler structure makes a significant improvement in tariff relativity and meets our terms of reference.

We also looked at how or whether this simpler structure could be applied to specialty textiles. The varied nature of specialty textiles precludes the application of a simpler structure. Most of these products are distinctive, uniquely designed and are important inputs, particularly for industrial uses. Although they incorporate textile fibres or yarns, they are not in competition with other fabrics. However, tariffs on these products are particularly high compared to those of our major trading partners, including the United States. In the end, we decided that a one-third across the board reduction in specialty textile tariff rates, roughly in line with the percentage reduction in tariffs on man-made and knitted fabrics, would be appropriate. Specialty textile tariff rates would still remain on average somewhat above those of the United States at the end of the implementation period.

(c) Recommendations to Convert Specific Duties to Ad Valorem Rates

A simpler structure of ad valorem tariffs is inconsistent with the use of specific and compound rates. It makes sense to eliminate specific duties. They create uncertainties in trade and are a vestige of the past. They discriminate among products of differing values. Their elimination would also be consistent with the direction set in international trade negotiations towards the exclusive use of ad valorem tariffs. Accordingly, we recommend that those compound rates and specific duties now in place for yarns, some wool fabrics and one specialty textile be converted to ad valorem rates. We propose that any reductions in the rates under the simpler structure be made on the basis of these new ad valorem rates. The actual conversion to ad valorem MFN rates would take effect as of the date of implementation of our recommendations.¹

3. Pace of Implementation of the Tribunal's Basic Plan

At the October hearing, three time frames were suggested:

- immediate implementation,
- a 10-year frame, and
- a five-year, back-end loaded phase in period.

1. A description of how compound rates and specific duties should be converted to ad valorem rates can be found in Volume 2.

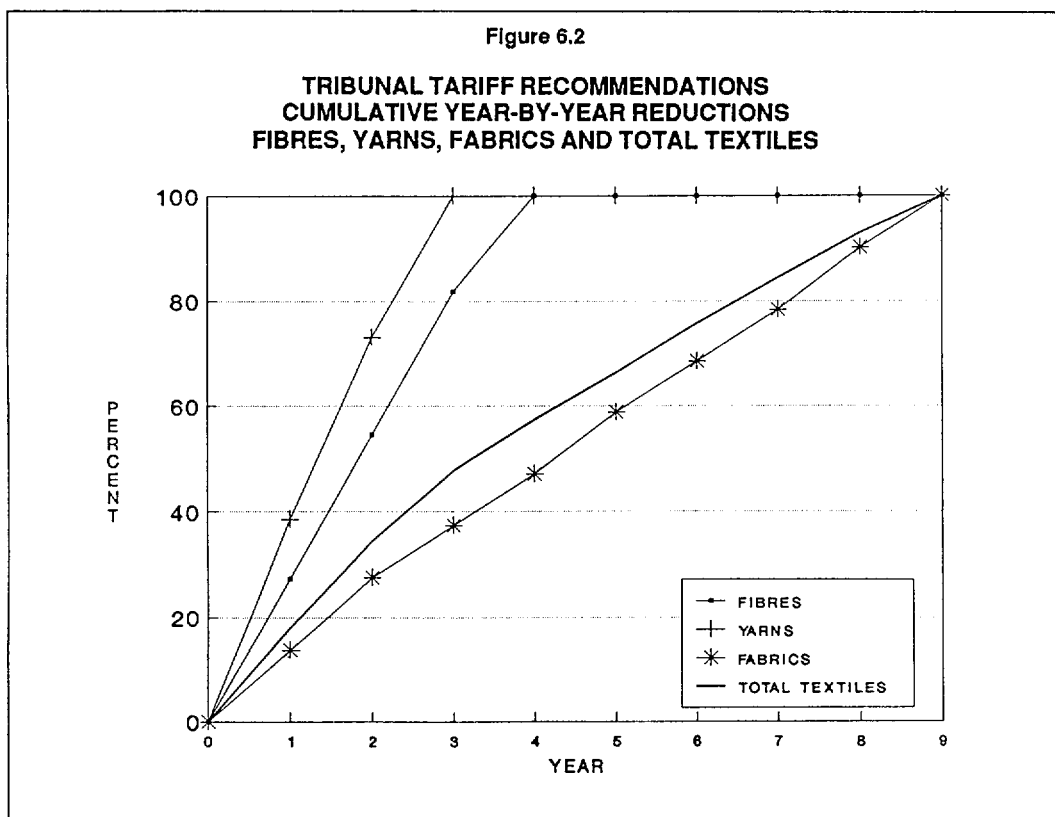
The CTI was opposed to any reductions in tariffs. It saw the current reference as one of three major changes in tariffs to which the textile industry would have to adjust. The textile industry stressed the need for time to adjust to the FTA. In addition to the Tribunal's recommendations, the textile industry could also be faced with further reductions resulting from the MTN. If there were to be any reductions as a result of this inquiry, they should be delayed as long as possible. In contrast, the clothing industry preferred that the tariff reductions be implemented as soon and as quickly as possible.

Textile products will be facing different magnitudes of reductions in tariffs, ranging from zero to nine percentage points. The Tribunal chose not to schedule reductions over a predetermined period, with tariffs on each product being given the same phase in period whatever the magnitude of the reduction in absolute terms. The Tribunal considered that the phase in period should take account of the differences in the absolute size of reduction in tariffs. For example, a reduction of three percentage points should be fully implemented before a seven percentage point reduction. This led us to conclude that reductions of one percentage point per year should be applied to tariffs on all products, with the length of the total phase in period for each tariff item being determined by the total amount of reduction. This would provide a simple mechanism for phasing in tariff reductions and give those industries facing larger cuts on a percentage point basis more time to adjust to lower rates than those industries facing smaller cuts.

For a number of products, the total reduction in tariff is not equal to a whole number. The Tribunal considers that the reduction of any remaining fraction of a rate should take an additional year. However, if the results of the MTN are known at the time the Government implements the recommendations, it could consider these fractional reductions in the context of any further reductions agreed to in the MTN.

Producers of man-made fibres face larger absolute reductions in tariffs than yarn manufacturers. The Tribunal's recommendation to reduce rates by one percentage point per year would mean that reductions in tariffs on yarns would be completed within three years, and those on fibres within four years. Reduced tariffs would be fully in place on both fibres, and particularly yarns, before being in place on fabrics, most of which will take up to nine years to be fully completed. (Figure 6.2 shows graphically how the phasing in of tariff reductions is differentiated). This would mean cost savings for fabric producers, thus mitigating the effects of their own tariff reductions. The longer phase in period for reductions in tariffs on fabrics would also ease adjustment for fibre and yarn manufacturers to the extent that tariffs on fabrics provide protection for their own production. The longer phase in period would also provide time for producers of natural fabrics, whose tariffs will remain the same or be only marginally lower, to adjust to increased competition from man-made fabrics on which tariffs will have been reduced significantly.

The textile industry has recently enjoyed a number of good years, but may face more difficult market conditions in the early 1990s if economic growth slows. Nonetheless, the industry is now in a relatively strong position, and it has a record of adaptability and resilience. It has undergone major structural changes in recent years and shown an ability to respond to changes in the trading environment, particularly if given sufficient notice and time to adapt. The industry will continue to have access to GATT or MFA safeguards, as well as anti-dumping and countervailing remedies.



4. Date of Implementation

The Minister's letter of reference indicated that the Government intended to begin implementing reductions in textile tariffs on April 1, 1990. We agree with the CTI that it would be preferable to delay implementation until the MTN has been completed and the Government has made full use of the proposed reductions as bargaining levers in the negotiations. Accordingly, we recommend that the changes begin to be implemented in 1991, as soon as possible after the results of the MTN are known. This approach takes into account the relatively short time remaining before the scheduled completion of the Uruguay Round at the end of 1990.

If there were any significant delay in the completion of the MTN, the Government should still consider following through with the tariff reductions in 1991, provided it is satisfied that Canada will get adequate credit for them in the negotiations. Furthermore, the coming into effect of the textile tariff reductions need not await full implementation of the general MTN results. To delay unduly the introduction of these tariff reductions would create uncertainties for producers and consumers of textiles.

5. Exceptions

The terms of reference asked the Tribunal to indicate whether there are specific textiles on which the tariff should not be reduced. In the course of the inquiry, we heard virtually no representations for specific exclusions from our recommendations, or for a longer phasing in of reductions for any product or groups of products. As already observed, the textile industry argued strongly that there should be no reductions at all.

Other evidence we considered, including work carried out by our research staff, did not lead us to the conclusion that any exceptions should be made to our recommendations. Our recommendations on the level of tariffs have a different impact on various parts of the industry. In particular, the maximum reduction to be applied to cotton fabrics will be 1.5 percentage points, much less than that applied to most other fabrics. In the course of testimony, the cotton sector was identified as one that was not performing quite as well as other parts of the textile industry. Finally, we believe that the phase in periods for the various reductions will provide the industry with the time needed to adjust.

6. Proposals for Acceleration or Elimination

Our terms of reference asked the Tribunal to consider whether there were any textile products imported from the United States or from the rest of the world on which tariffs should be reduced at a faster pace or eliminated. The Tribunal received proposals from 19 parties for the elimination of MFN tariffs on 92 specific product categories. It also received submissions from 7 parties in favour of the accelerated reduction of tariffs on 72 specific products or groups of products under the FTA. Many of those FTA proposals were also presented to the Government in the context of its recent negotiations with the United States on accelerated tariff reductions under the FTA.

Most of the parties submitting requests did not provide the Tribunal with any supporting economic evidence. Also, in a number of instances, the goods at issue were insufficiently well-defined for economic analysis or tariff identification purposes. However, almost all of the requests, except those supported by the textile industry in the context of negotiations under the FTA, were opposed by the Canadian Textiles Institute or by individual firms in the textile industry.

The time allowed for the conduct of the inquiry did not permit the Tribunal to conduct a full survey of all potentially interested parties with respect to the products at issue, or to undertake a thorough examination of relevant facts, where these could be established. Accordingly, the Tribunal is of the opinion that it does not possess sufficient information to formulate recommendations in relation to the majority of goods brought to its attention.

However, in response to the respective requests of Hartford Fibres Ltd. and IKO Industries Ltd. (supported by CanRoof Corporation Inc.), we propose the creation of the following two concessionary tariff provisions, with duty-free entry for the end uses specified:

- filament tow, solely of polyester, black, of tariff item 5501.20.00, for use in the manufacture of flocking fibres; and
- non-woven mat of polyester fibres of tariff item 5603.00.00, for use in the manufacture of modified bitumen roofing.

In light of further review and additional fuller information, the Minister may also feel that certain of the other requests made to the Tribunal for the elimination or accelerated reduction of tariffs are worthy of support.

In this connection, the Tribunal would especially suggest that further consideration be given to the request of Firestone Textiles Company for the accelerated elimination of duties under the FTA in respect of tire cord fabrics of high

tenacity yarns (presently dutiable at 12.5 percent MFN under HS heading 59.02). In addition, the Tribunal is particularly aware of the need for more information in regard to the request of K-Bro Textiles Technologies Inc. for the elimination of duties on "Rotecno" medical products of polyester, apparently classifiable under existing tariff item 5407.60.00 at 25 percent MFN.

The full listing of requests and further comments can be found in Volume 2 of the report.

CHAPTER VII

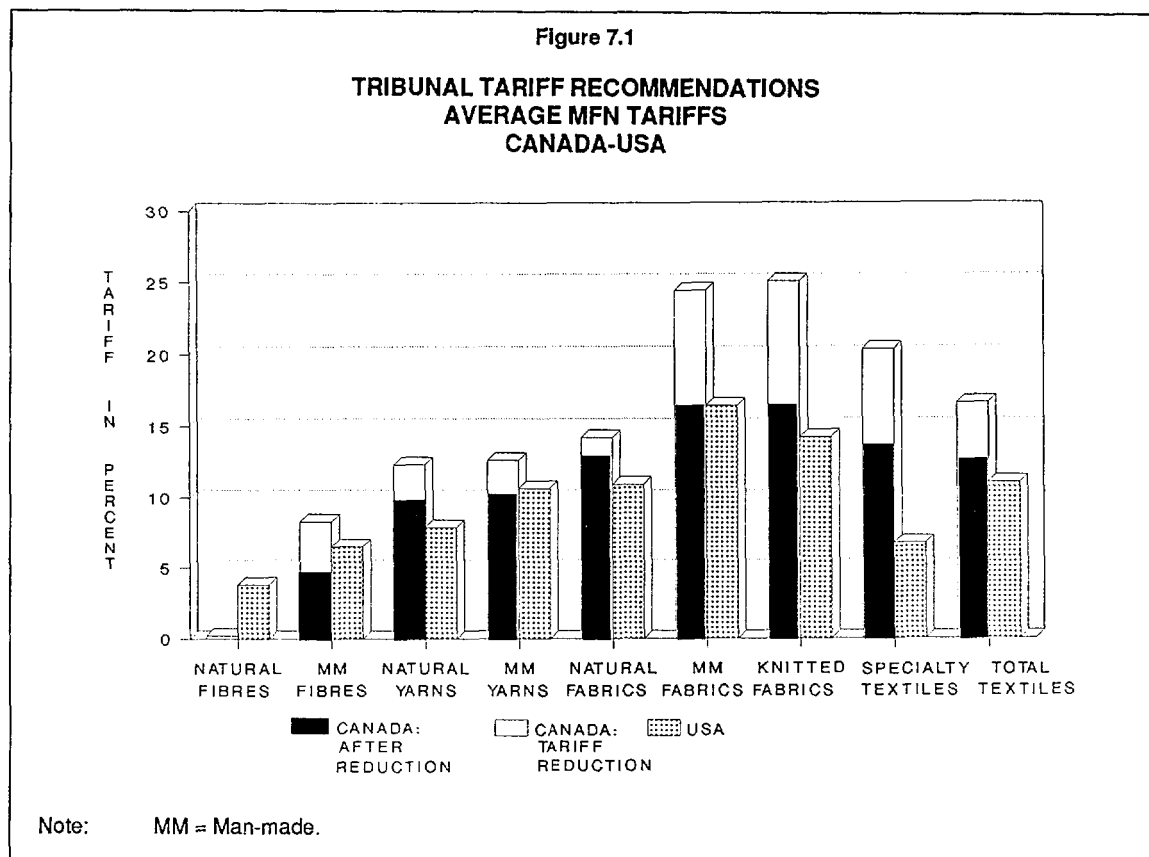
IMPLICATIONS OF THE RECOMMENDATIONS

1. Introduction

In this chapter, we describe in more detail how our tariff recommendations affect average MFN tariffs for particular textile product groups. We also look at the impact they have on levels of effective protection in the textile production chain from fibres through fabrics to clothing. Finally, this chapter reports on the economic effects and the benefits and costs of the recommended tariff reductions.

2. Main Changes In the Canadian Tariff Structure

Figure 7.1 shows average MFN textile tariffs reflecting the results of the tariff changes recommended by the Tribunal in comparison with the current averages in Canada and the United States for eight major product groupings and total textiles. The actual average MFN rates are shown in Table 7.1.



The Tribunal's recommendations would introduce more simplicity into the structure of tariffs for textiles. It can be seen as a first step in a process towards a comprehensive structure in which all rates for similar textile products are the same. Canada's position on textile tariff reductions in the current MTN, and in future trade negotiations, could take into account the objective of further reducing the dispersion of rates within the simpler structure that we have proposed.

<p style="text-align: center;">Table 7.1</p> <p style="text-align: center;">TRIBUNAL TARIFF RECOMMENDATIONS AVERAGE MFN TARIFFS</p>					
Product Group	Existing Canadian Tariff %	Recommended Tariffs %	Percentage Point Reduction	Percentage Change	Average US MFN Tariff %
Fibres: Natural	0.2	0.1	0.1	50.0	3.8
Man-Made	8.3	4.9	3.4	41.0	6.5
Sub-Total	2.5	1.5	1.0	41.5	4.6
Yarns: Natural	12.3	9.7	2.6	21.1	7.9
Man-Made	12.6	10.0	2.6	20.6	10.6
Sub-Total	12.5	9.9	2.6	20.8	9.5
Fabrics: Natural	14.2	12.6	1.6	11.3	10.9
Man-Made	24.8	16.0	8.8	35.5	16.4
Sub-Total	19.0	14.2	4.9	25.7	12.9
Knitted Fabrics	25.0	16.0	9.0	36.0	14.2
Specialty Textiles	20.3	13.5	6.8	33.5	8.6
Total Textiles	16.6	12.3	4.3	25.9	11.1
<p>Note: Average MFN tariffs resulting from Tribunal recommendations and existing Canadian and US MFN tariffs weighted by rest of world imports.</p>					

The overall impact of the recommendations will be to reduce the range of tariffs applicable to products in the categories of fibres, yarns and fabrics. MFN tariffs on fibres will range from 0 to 5 percent. Nearly all yarns will be subject to the same MFN rate of 10 percent. The most significant changes in MFN tariffs concern fabrics. Under the simpler regime that we have recommended, the difference between the highest and lowest (non-zero) tariffs will be reduced from 13 to 4 percentage points. Firms facing reductions in tariffs of as much as nine percentage points will see their rate of border protection fall by one percentage point per year in nine phases. This long phase in period will provide firms with time to adjust to competition for fabrics they produce.

Although MFN tariffs on specialty textiles were not included as part of the simpler structure, the proposed one-third reduction in tariffs on most of these products would put them at levels which are very close to, or not much below, the maximum 16 percent MFN tariff proposed for fabrics.

Compared to the existing level of MFN tariffs in the United States, the new Canadian MFN rate structure would be, on average, marginally higher (12.3 percent in Canada versus 11.1 percent in the United States). The new structure is even higher in comparison to the EEC, Japan, the United States and the MFN composite textile tariff average of 9.4 percent.¹

The average reduction in Canadian textile tariffs is calculated to be about 26 percent, or 4.3 percentage points. Considering rates for individual tariff items, absolute reductions range from 2.5 percentage points for most yarns, to 9 percentage points for

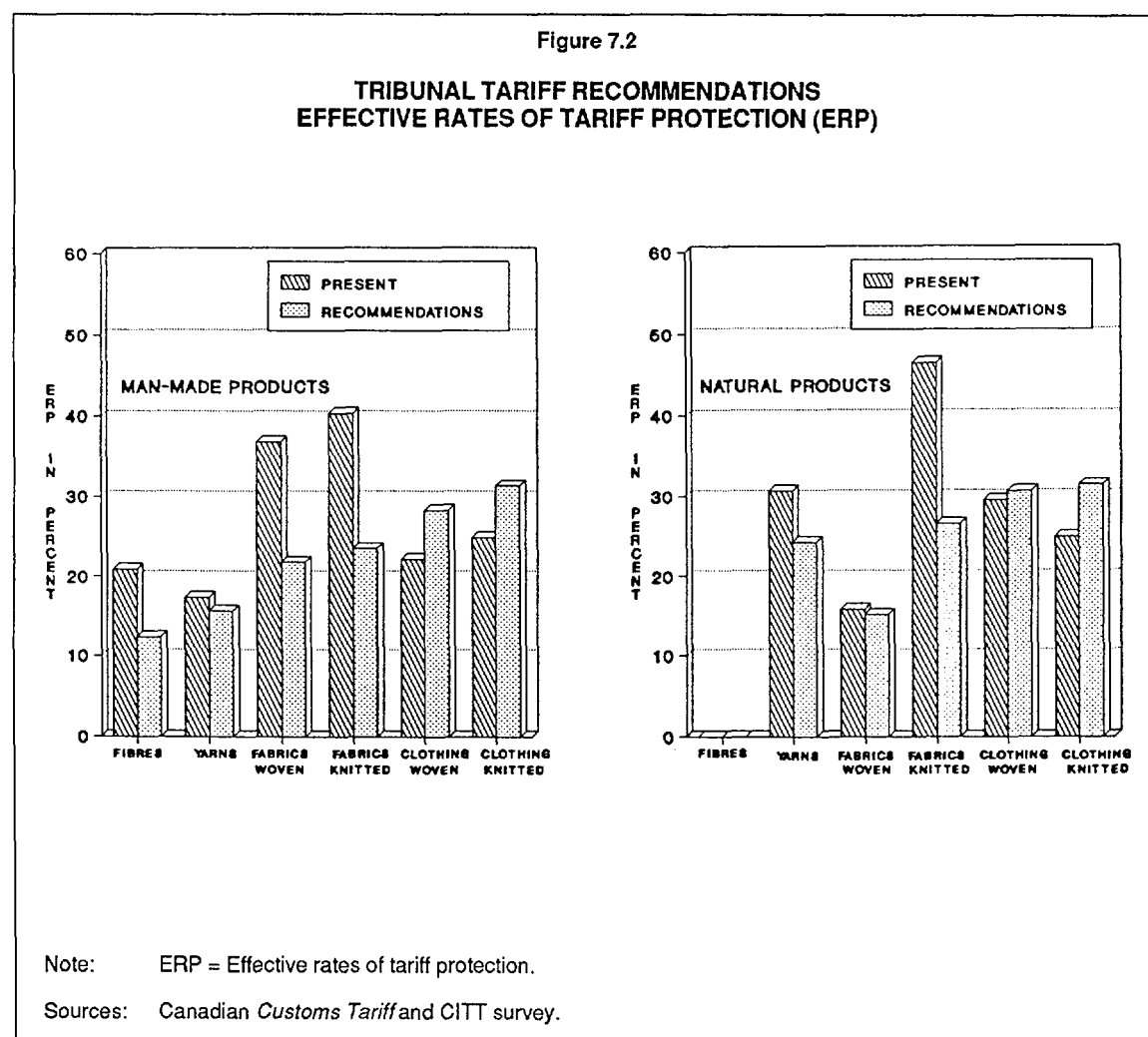
1. As estimated on an FOB valuation basis. Corresponding rates on a CIF valuation basis are 11.5 percent, 10.5 percent, 9.9 percent for Canada, the United States and the composite rate.

nearly all man-made fabrics. Tariffs on most man-made fibres would be reduced by 3.5 percentage points.

The recommendations also call for a conversion of specific and compound duties to their ad valorem rates. Yarn rates which now enter at 10 percent plus 11¢ per kg would be converted to an ad valorem rate of 12.5 percent, and then reduced by one percentage point per year. The compound rate of the lesser of 25 percent or \$3.45 per kg applicable to many wool fabrics and one specialty textile would be converted to an ad valorem rate of 11.8 percent.¹

3. Relativity and Effective Protection

Our recommendations on MFN tariffs result in changes in the level of effective protection both within the main textile manufacturing phases and in the downstream industries, particularly clothing. Figure 7.2 shows effective rates of tariff protection calculated using both current and recommended MFN tariffs on textiles.



1. As noted in Chapter IV, 11.8 percent is the MFN ad valorem equivalent which is used as a benchmark for periodically adjusting the specific duty on these products. See Volume 2 for a further discussion of the conversion of specific duties.

Within primary textiles, there is a significant narrowing of levels of effective protection for man-made fibre products, but also a steady gradation of these levels throughout the production chain. A difference between levels of effective rates of tariff protection of over 22 percentage points is halved to about 12 percentage points. Effective protection is reduced at each phase. The effective rate of tariff protection on knitted fabrics is reduced from 40.4 to 23.5 percent.

There are more modest changes in effective protection in the natural fibre chain in primary textiles. However, the range of levels of effective tariff protection is also reduced from 20 to 11 percentage points. While the effective protection for natural yarns is lowered somewhat, but remains quite high, there is a gradation of effective protection in the remainder of the production chain.

Lower tariffs on inputs result in a significant increase in the rate of effective protection for clothing. The largest increase is observed for clothing made from knitted and woven man-made fabrics. Effective protection for clothing made from woven natural fabrics increases only marginally. Using the tariff rates we have recommended, effective protection for clothing would exceed that of any of the earlier phases of the textile production chain.

4. Industry Prices, Output and Employment

The econometric model described in Chapter V was used to estimate the impact of the recommended size and pace of the tariff reductions on industry prices, output and employment. Given that the magnitude of the recommended tariff reductions is smaller than either of the two tariff options described earlier in the report, the resulting changes are also smaller.

(a) Textile Industry

As shown in Table 7.2 and Figure 7.3, the changes in annual growth rates for both output and employment due to the tariff reductions for the textile industry are relatively small percentages of the projected base case growth rate.¹ These relatively small effects are not surprising given that:

<p style="text-align: center;">Table 7.2</p> <p style="text-align: center;">COMPARISON OF ECONOMIC CHANGES FOR THE TEXTILE INDUSTRY</p> <p style="text-align: center;">1990-2000</p> <p style="text-align: center;">(Average Annual Percent Changes)</p>			
	Base Case	After Tariff Reductions	Difference
Output	3.0	2.8	-0.2
Employment	-1.0	-1.2	-0.2
Sources: Informetrica Limited and CITT survey.			

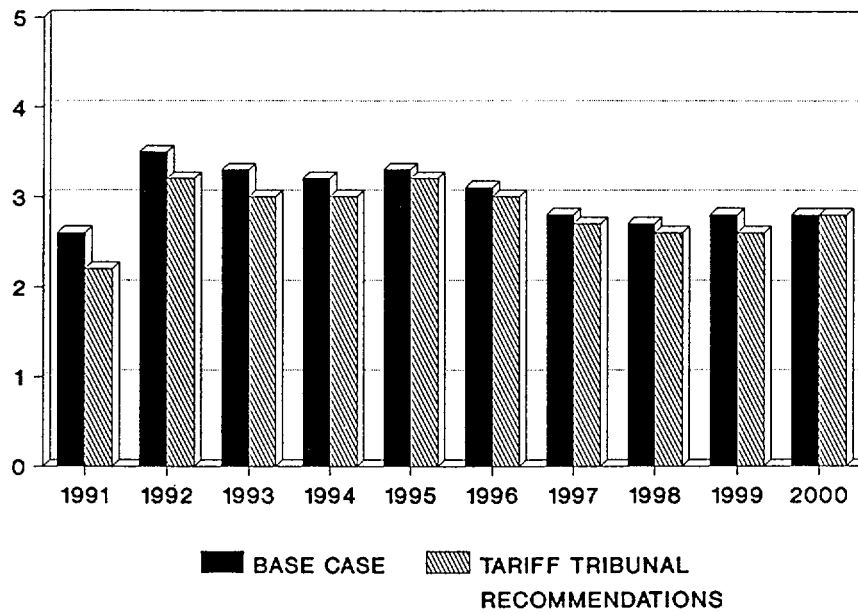
1. The base case growth rate is derived from the econometric model's projection for the textile industry in the absence of tariff reductions.

Figure 7.3

**ECONOMIC EFFECTS OF THE TRIBUNAL TARIFF RECOMMENDATIONS
ON THE TEXTILE INDUSTRY**

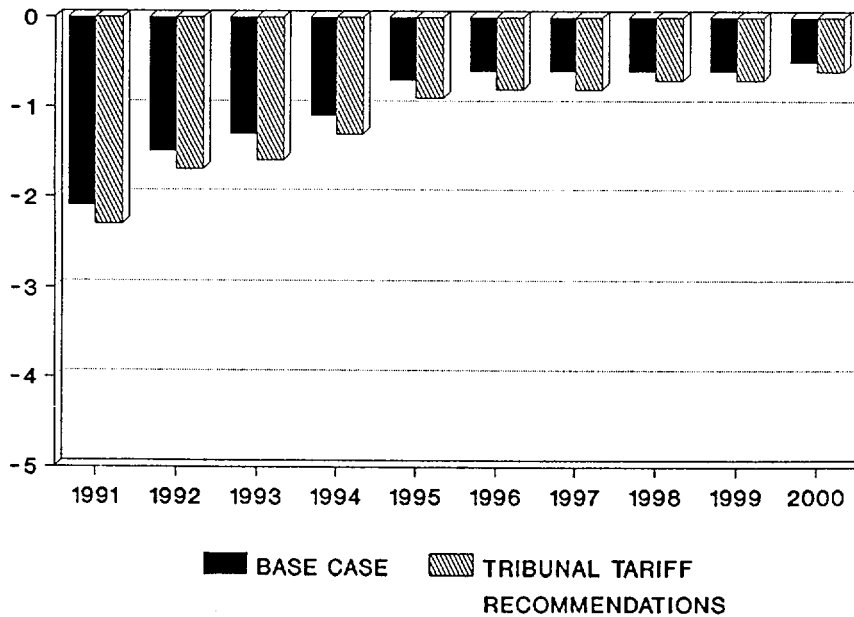
(a) OUTPUT GROWTH

(Annual Percent Change)



(b) EMPLOYMENT DECLINE

(Annual Percent Change)



Source: Informetrica Limited.

- the tariff reductions apply only to tariffs on imports from the rest of the world;
- there are some offsetting increases in domestic demand;
- the domestic industry is expected to lower its prices to minimize the loss of domestic market share; and
- the tariff changes are phased in over time.

(b) Clothing and Other Downstream Industries

For the clothing industry, the model projects a small increase in output and employment over the period. There is a similar increase in output for other downstream industries. As well, prices fall only marginally, mainly due to the small share which the tariff represents in the final consumer price of a product made using textiles.

5. Benefits and Costs

The benefits and costs arising from the recommended tariff reductions were estimated using the methodology described in Chapter V. Estimates were prepared using three assumptions for the price response of the Canadian textile industry to the reduction in textile tariffs.

1. No Price Response
2. Full Price Response - No Cost Saving
3. Full Price Response - Full Cost Saving

In the first case, it was assumed that domestic producers would not lower their prices to match the reduction in import prices resulting from the tariff reduction. The result would be a greater loss of market share to imports than would otherwise be the case. In the second case, a domestic price reduction was assumed to occur as domestic producers would cut prices below full cost in order to hold customers in the face of import price cuts. This action, without any offsetting cost savings, would erode profits. In the third case, a domestic price reduction is assumed to take place to reflect lower costs due to the rationalization of domestic production in response to the increased price competition from imported textiles. In this case, profit levels are unaffected. The benefits and costs under the three price assumptions are set out in Table 7.3.

The benefits exceed the costs by a wide margin for all three price assumptions. These price assumptions cover a wide range of possible responses by the textile industry to the lower tariffs. In choosing the most likely price response assumption, it is useful to review the industry's response to the lowering of tariffs under the FTA. The testimony given at the hearings indicated that several firms are now embarked on investment programs to rationalize production to reduce costs. These reactions suggest that further efforts will be made to reduce costs to meet the increased price competition from rest-of-world textile imports. If this occurred, the net benefits arising from the proposed reduction in textile tariffs would tend to be in the upper end of the range of benefits set out in Table 7.3. That is, the present value (in 1989 dollars) of the net benefits of the tariff reductions to the Canadian economy could be as high as \$226 million.

<p align="center">Table 7.3</p> <p align="center">NET BENEFITS OF RECOMMENDED TARIFF REDUCTIONS</p> <p align="center">(Millions of 1989 Dollars)</p>			
	No Domestic Price Response	Domestic Price Response with Price Cut	
		Reducing Profits ⁽¹⁾	Reflecting a Cost-Saving
Consumer Gain on ROW ⁽²⁾ Imports	248.6	247.2	247.2
Lost Tariff Revenue on ROW Imports	-175.0	-188.5	-188.5
Lost Tariff Revenue on US Imports	-4.1	-7.1	-7.1
Consumer Gain on Domestic Products	N.A.	179.4	179.4
Lost Profits for Domestic Producers	N.A.	-181.3	N.A.
Net Gains	69.6	49.7	231.0
Social Adjustment Costs	4.8	4.8	4.8
Net Benefits ⁽³⁾	64.8	44.9	226.2
<p>Notes: (1) Reducing quasi-rent which is the economist's term for contribution to overhead. (2) Imports from all countries other than the United States. (3) Net present value for the period from 1990 to 2005. N.A. = Not Applicable.</p> <p>Source: Abt Associates of Canada.</p>			

Regional estimates of the benefits and costs of the recommended tariff reductions were prepared for Quebec and Ontario, where roughly 90 percent of textile employment is located, and for the rest of Canada. The net welfare gains for consumers were allocated according to population shares in the regions, while the social adjustment costs were allocated according to the shares of employment and the differential assumption for the speed of employment adjustment.¹ The net impact of the changes, or the net present value, is smaller for Quebec than Ontario as shown in Table 7.4. This reflects a smaller population in Quebec than in Ontario, and hence a smaller share of the overall national benefit and greater employment adjustment costs.

6. Highlights

A simpler structure of maximum tariffs of 5 percent for fibres, 10 percent for yarns and 16 percent for fabrics, along with a one-third reduction of tariffs on specialty textiles, would reduce the average MFN tariff on all textiles by approximately 26 percent. The reduction in MFN tariff rates would range from 2.5 percentage points for yarns, to 3.5 percentage points for fibres and to 9.0 percentage points for fabrics. Reductions for most specialty textiles are close to those for man-made fabrics.

1. See Chapter V.

<p style="text-align: center;">Table 7.4</p> <p style="text-align: center;">REGIONAL DISTRIBUTION⁽¹⁾ OF NET BENEFITS</p> <p style="text-align: center;">OF RECOMMENDED TARIFF REDUCTIONS</p> <p style="text-align: center;">(Millions of 1989 Dollars)</p>				
	Quebec	Ontario	Rest of Canada	Total
Net Welfare Gain	12.7 to 59.1	18.1 to 84.3	18.9 to 87.6	49.7 to 231.0
Social Cost	3.0	1.3	0.5	4.8
Net Benefits ⁽²⁾	9.7 to 56.1	16.8 to 83.0	18.4 to 87.1	44.9 to 226.2
<p>Notes: (1) The range of net benefits arising from the various price-response assumptions used in Table 7.3.</p> <p>(2) Net present value for the period 1990 to 2005.</p> <p>Sources: Abt Associates of Canada and CITT survey.</p>				

Average MFN tariffs under the new structure and rates would be marginally higher than those of the United States and quite a bit higher than those of the EEC and Japan. The dispersion of rates in the current Canadian structure would be reduced significantly, particularly for fabrics. The tariff recommendations would lead to changes in the pattern of effective tariff protection in the textile production chain. The most significant change is an increase in the rate of effective protection for clothing. A smoother progression in effective protection at the fibre, yarn and fabric phases would also result.

The economic effects of the proposed tariff reductions are expected to be modest, especially when compared with the projected 10-year growth rates used by Informetrica Limited. For the textile industry, there would be a relatively small base case reduction in the annual growth rates for both output and employment. For the clothing and other downstream industries, there would be a marginal increase in output and employment and a marginal reduction in prices over the period of the reduction in tariffs.

Estimates of the benefits and costs flowing from the recommended tariff reductions were prepared using a range of price behaviour assumptions in response to lower prices for imported textiles. The testimony given at the hearings indicated that several firms have already begun investment programs to rationalize production to reduce costs to better compete at home and in export markets. The benefit-cost analysis, combined with the testimony of the textile industry, suggest that net benefits to the Canadian economy from the reduction in textile tariffs for imports from the rest of the world will be significant.

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GLOSSARY OF ACRONYMS

CAMI	Canadian Apparel Manufacturers Institute
CANSIM	Canadian Socio-Economic Information Management System
CIF	Cost, Insurance, Freight
CIRB	Canadian Industrial Renewal Board
CITT	Canadian International Trade Tribunal
CPE	Centrally Planned Economies
CTI	Canadian Textiles Institute
EC(12)/EEC	European Economic Community
ERP	Effective Rate of Tariff Protection
FOB	Free on Board
FTA	Canada - United States Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
HS	Harmonized Commodity Description and Coding System
ISTC	Industry, Science and Technology Canada
MFA	Multi-fibre Arrangement
MFN	Most Favoured Nation
MTN	Uruguay Round of Multilateral Trade Negotiations
NTB	Non-Tariff Barriers
ROW	Rest of World Excluding Canada and United States
SIC	Standard Industrial Classification
SITC	Standard International Trade Classification System
TSB	Textile Surveillance Body (of GATT)
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USITC	United States International Trade Commission
VER	Voluntary Export Restraint

ANNEXES

Annex A

Mr. John C. Coleman
Chairman
Canadian International Trade Tribunal
Journal Tower South
365 Laurier Avenue West
19th Floor
Ottawa, Ontario
K1A 0G7

Dear Mr. Coleman:

I am writing, pursuant to Section 19 of the Canadian International Trade Tribunal Act, to direct the Canadian International Trade Tribunal, to provide advice on the Government's announced plan to reduce the tariffs on textile fibres, yarns and fabrics to levels comparable with those of other industrialized countries, particularly the United States, in annual stages over a ten-year period beginning April 1, 1990.

As you know, on March 22, 1988, I announced a three-part program of tariff relief measures to strengthen the competitive positions of the Canadian textile and apparel industries in the domestic market. This initiative included six duty remission programs, tariff reductions on thirteen specialty fabrics not made in Canada, and a plan to progressively reduce textile tariffs down to the levels of other industrialized countries over a ten-year period, commencing in 1990. When these measures were announced, I indicated that the Government would ask the CITT for an analysis of the economic impact of this decision, and would seek its advice on the levels and timing of the tariff reductions.

Canada's textile tariffs are almost twice as high as the textile tariffs of other major industrialized countries, including our major trading partner, the United States. Traditionally, the tariffs on yarns and fabrics, particularly the latter, have generally been maintained at high levels to protect the domestic textile industry, which has, for many years, been facing stiff import competition. However, since these input materials constitute a significant portion of the overall cost of manufacturing finished products, the effect of this policy has been to increase costs for the apparel industry, for many other downstream industries which use textiles in their operations, and for consumers.

Normally, the tariffs on inputs for Canadian manufacturers are lower than those on the finished product, thus providing a reasonable level of effective protection at each stage of the manufacturing process. This relativity does not exist in the textile and apparel sectors where, for example, the tariffs on the finished product, apparel, are about the same as the tariff on many of the fabric inputs. Nor does it exist in other sectors which rely on textile inputs; in many cases the tariff on the finished product is actually lower. This tariff structure has placed downstream industries at a competitive disadvantage in the Canadian market against imports of the finished products.

Moreover, the measures which domestic textile producers have taken to achieve greater economies of scale by rationalizing product lines have caused the apparel industry to resort increasingly to the use of offshore fabrics to provide the variety and style of inputs needed to maintain their markets in Canada.

These factors argue the need to lower the tariffs on textiles to a level more in line with those of other industrialized countries. Such action should take into account major changes which will be occurring in Canada's trading arrangements, specifically the implementation of the Canada-U.S. Free Trade Agreement and the Multilateral Trade Negotiations now in progress.

Tariff reductions would have to be implemented in a manner that takes into account the importance of the domestic textile industry to the Canadian economy. They should be consistent with the textile industry's ongoing efforts, through heavy investment and rationalization of production, to enhance the viability of its operations and to adjust to the international trading environment. They should also take into account the significant role the industry plays in the economic well-being of many small communities in Canada.

In considering the plan to lower Canada's tariffs on textile fibres, yarns and fabrics to levels comparable with those of other industrialized countries, particularly the United States, in annual stages over a ten-year period beginning April 1, 1990, the Tribunal should indicate whether there are some areas where tariff reductions should occur faster, slower or not at all. I would direct the Tribunal to hear the views of all interested parties before determining the manner in which tariff reductions could best be implemented.

Specifically, the Tribunal is directed to:

- assess the economic impact of bringing Canada's textile tariffs down to levels comparable with those of our major industrialized trading partners;
- make recommendations on the level and pace of tariff reductions that will maximize the economic gains to Canada without causing undue hardship to domestic suppliers of textile products and, in this latter regard, indicate whether there are specific textiles on which the tariff should not be reduced;
- make specific recommendations on the ultimate level to which textile tariffs should be reduced over the next ten years, bearing in mind Canada's objectives in the Uruguay Round of Multilateral Trade Negotiations (MTN) currently underway;
- make recommendations on what should be the pace of the tariff reductions and, specifically, whether the tariffs on some fabrics and yarns could be reduced at an accelerated pace without causing injury to textile producers;
- make recommendations on the scope for accelerated bilateral reductions of textile tariffs under the Free Trade Agreement with the United States;
- assess and make recommendations on the level of relativity that should exist in the tariff protection at the various levels of the manufacturing chain (i.e., from fibres and yarns through fabric to finished product).

I would appreciate receiving the report of the Tribunal by December 31, 1989.

Yours sincerely,

Michael H. Wilson

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