



**REPORT TO
THE MINISTER OF FINANCE**

**REQUEST FOR TARIFF RELIEF BY
KUTE-KNIT MFG. INC.
REGARDING
COMBED, RING-SPUN, POLYCOTTON,
BLENDED YARNS**

JULY 5, 1995

KUTE-KNIT MFG. INC.

REQUEST NO.: TR-94-002

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INTRODUCTION

On July 14, 1994, the Canadian International Trade Tribunal (the Tribunal) received terms of reference from the Minister of Finance (the Minister) pursuant to section 19 of the *Canadian International Trade Tribunal Act*.¹ The Minister directed the Tribunal to investigate requests from domestic producers for tariff relief on imported textile inputs for use in their manufacturing operations and to make recommendations in respect of those requests to the Minister.

Pursuant to the Minister's reference, on December 28, 1994, the Tribunal received a request from Kute-Knit Mfg. Inc. (Kute-Knit) of Montréal, Quebec, for the immediate and permanent removal of the customs duty on importations, from all countries, of combed, polycotton, blended yarns in the following sizes and compositions: four yarn sizes (12/1, 18/1, 24/1 and 30/1) in three blend compositions (52:48, 50:50 and 55:45); and one yarn size (40/1) in three blend compositions (52:48, 50:50 and 65:35). In its request, Kute-Knit stated that these yarns are used in the production of greige fabrics and, subsequently, children's clothing. In a letter dated April 3, 1995, Kute-Knit clarified that its request, as discussed with Tribunal staff at a plant visit on March 9, 1995, was limited to **ring-spun** yarns of this description. As clarified, these goods constitute the subject yarns.

Kute-Knit requested immediate and permanent tariff relief in respect of the subject yarns imported from countries subject to the MFN tariff commencing on September 1, 1994, or, alternatively, on the date of the submission of the request. Kute-Knit indicated that the subject yarns are imported under tariff item Nos. 5509.53.00.22, 5509.53.00.23 and 5509.53.00.24 of Schedule I to the *Customs Tariff*.²

On February 15, 1995, the Tribunal, being satisfied that the request was properly documented, issued a notice of commencement of investigation, which was widely distributed and published in Part I of the February 25, 1995, edition of the Canada Gazette.

As part of the investigation, the Tribunal's research staff sent questionnaires to potential producers, importers and users of yarns identical to or substitutable for the subject yarns. Questionnaires were also sent to importers of fabrics identical to or substitutable for fabrics made from the subject yarns and to users of fabrics made from the subject yarns. Letters were also sent to a number of government departments requesting information and advice.

A staff investigation report, summarizing the information received from these departments and firms that responded to the questionnaires, was provided to the parties that had filed notices of appearance for this investigation. These parties are: (1) Kute-Knit; (2) Glendale Yarns Inc. (Glendale); (3) the Canadian Textiles Institute (CTI); (4) Perfect Dyeing Canada Inc.; (5) Château Lingerie Manufacturing Inc. (Château); and (6) St. Lawrence Textiles Inc. (St. Lawrence).

The CTI filed a submission on behalf of Canadian yarn manufacturers, to which Kute-Knit provided a response. A public hearing was not held for this investigation.

1. R.S.C. 1985, c. 47 (4th Supp.).

2. R.S.C. 1985, c. 41 (3rd Supp.).

PRODUCT DESCRIPTION

The subject yarns are ring-spun and made from a combination of combed, natural cotton fibres and polyester fibres. The cotton fibres are mixed with polyester fibres in which the fibre-forming substance is any chain synthetic polymer composed of at least 85 percent by weight of an ester of a dihydric alcohol and terephthalic acid. The quality of yarn is usually measured by count variation, strength, evenness, smoothness and defects per 1,000 metres. Combing and ring spinning enhance the quality of yarn.

According to the Department of National Revenue, the subject yarns are classified for customs purposes under tariff item No. 5509.53.00. They are dutiable at 10 percent ad valorem under the MFN tariff and the GPT; at 3 percent ad valorem and 3.3¢/kg under the U.S. tariff; and at 8 percent ad valorem and 8.8¢/kg under the Mexico tariff.

Fibres undergo a number of processes before they become **yarns**. The first step is **blending**, whereby various types, qualities and grades of fibres are brought together. Next comes **carding**, which involves brushing the fibres, removing foreign matters and forming strands called **slivers**.

In order to make some types of higher-quality yarns, the slivers are next sent for **combing**, which separates desirable fibres from undesirable stock and removes the remaining impurities from the fibre stock. This process makes combed yarns superior to carded yarns. Next comes **drawing**, which is the process of evening out irregularities, elongating the slivers and, in some cases, combining slivers of different fibres to achieve the correct percentage blends. Finally, **roving** reduces the drawing sliver down to a size suitable for ring spinning and, if required, adds a twist to the yarn.

Open-end and air-jet spinning create yarns directly from slivers. They are high-speed, low-cost, efficient and capital-intensive. They by-pass the drawing and roving processes that must be performed in ring spinning. These processes add to the cost of ring-spun yarns, but improve their quality.

Replies to questionnaires show that known imports of the subject yarns were significantly greater than 400,000 kg and had a value for duty of more than \$2.0 million during 1994. These imports are expected to increase to over \$2.5 million in 1995. The duties on expected imports in 1995 would exceed \$250,000.

Based on published data by Statistics Canada under the three relevant tariff items, the subject yarns are imported mostly from the United States, Pakistan and Brazil. These data, however, include more than the subject yarns and indicate that Pakistan accounts for over 40 percent of total imports.

Annual domestic consumption of the subject yarns cannot be estimated, but available data indicate that combed, ring-spun yarns are much more expensive than carded yarns.

REPRESENTATIONS

Kute-Knit alleged that there is no manufacturer of combed, ring-spun, polycotton, blended yarns in Canada nor suitable substitutable yarns available from domestic production.

Kute-Knit knits the subject yarns into greige fabrics, dyes the fabrics and manufactures children's wear in the middle-to-high price range at its plant in Montréal. Although Kute-Knit started in 1955 as a manufacturer of children's wear using outside contractors, by 1972, it had become a vertically integrated manufacturer of these products. Kute-Knit uses a major proportion of its total production of greige fabrics to produce children's garments, and the balance is sold at arm's length to other fabric users.

Of the five knitters that responded to the Tribunal's user's questionnaire, St. Lawrence and Château of Montréal support the request for tariff relief, while Nova Scotia Textiles, Limited of Windsor, Nova Scotia, and Agmont Inc. and Consoltex Inc. of Montréal oppose the request. The firms opposing the request submitted that: (1) the subject and substitutable yarns are produced in Canada; (2) if sales from domestic production for domestic consumption continue to be displaced by imports, there will soon be no domestic yarn industry, and their major source of supply will be jeopardized; and (3) a tariff concession to Kute-Knit will result in a comparative disadvantage to knitters that compete with Kute-Knit in the apparel market with garments made from fabrics knitted from substitutable yarns.

Dominion Specialty Yarns (DSY) opposes the removal of the customs duty on imports of combed, ring-spun yarns because it alleged that it produces the subject and substitutable yarns and has sufficient excess capacity to supply increasing market demand. DSY indicated that, if the tariff relief is granted, it will cause a decline of 10 percent (the equivalent duty) in its prices of both the subject and substitutable yarns. Such a drop in domestic prices would have a serious impact on its profitability and the viability of the plants producing these goods.

Dominion Yarn Company (DYC) of Saint-Laurent, Quebec, which produces only carded, open-end spun yarns, also opposes the request on the grounds that its carded yarns are substitutable for combed yarns. DYC argued that "[t]here is a rather marginal degree in quality differentiating carded and combed yarns today." Moreover, it contended that "[w]here fabric or garments are sold with a reference to a 'combed' cotton content, they generally fetch a higher selling price than equivalent 'carded' goods, in recognition of the additional cost associated with the combing process." According to DYC, the granting of the tariff relief would result in price reductions of the goods that it produces, which would eventually lead to financial losses and layoffs.

Similarly, Glendale of Hamilton, Ontario, a third yarn spinner of carded, open-end spun yarns, alleged that carded yarns are substitutable for combed yarns. It further alleged that an erosion of 10 percent or more in the landed cost of the subject yarns will reduce its return on sales, thus leading to layoffs.

In its preliminary submission, the CTI, which represents Canadian manufacturers of textiles, opposed the request because the subject and substitutable yarns are produced in Canada and because duty-free entry of the subject yarns would be damaging to domestic production, sales, market share, pricing, profitability, employment and investment in Canada. Subsequently, in commenting on the staff investigation report, the CTI indicated that combed yarns cost more to produce and are sold at prices that are higher than those of other yarns; the extra price is paid by knitters that place value on the properties and name of combed yarns. The CTI contended that it is possible for a knitter "to insist subjectively that for him there is no substitute for a combed yarn." The CTI also made an issue of the fact that the description in the notice of commencement of investigation did not correspond to what was investigated, thereby modifying the product

definition. The CTI further observed that the tariff relief would not represent a significant factor to users of the subject yarns, but that, to the domestic yarn-producing industry, it would make the difference between viable sales and unsustainable losses. Moreover, it contended that the price differential between combed yarns and carded yarns, which may vary from time to time and from count to count, is similar, in magnitude, to the current MFN tariff on yarns. By removing the tariff, the injury would extend to other yarns, because the subject yarns would be available in Canada at the price normally paid for carded yarns.

Kute-Knit responded to the staff investigation report and the CTI's submission by stating that what is significant about the tariff relief is the absolute dollars that are paid annually in duties on imports of the subject yarns and not the amount of duties as a percentage of the price of the finished garment. For Kute-Knit, the savings in duty could make the difference between a profit and a loss in this fiscal year. Kute-Knit further argued that there is a qualifiable distinction between combed yarns and carded yarns and that the latter are much cheaper. Furthermore, it mentioned that, if the tariff relief is granted, there will not be a switch from domestically produced carded, open-end spun yarns to imported combed, ring-spun yarns, because of the inherent higher international price for the latter and because there exists in the marketplace a clear distinction between the two yarns and a consumer preference for each type of yarn.

ANALYSIS

In this particular case, the Tribunal is concerned with the issues of, first, whether or not combed, ring-spun yarns are still produced in Canada and, second, whether or not carded and open-end and air-jet combed yarns are substitutable for the subject yarns.

DSY claims to produce yarns identical to the subject yarns imported by Kute-Knit. In an effort to verify those claims, the Tribunal made several requests, but DSY did not supply any data relating to recent domestic production of combed, ring-spun yarns. Instead, it asserted that "sales may be taken as a proxy for production." The Tribunal notes that there could be a number of possible sources of supply for DSY's sales other than its own current domestic production. Moreover, some of the data supplied by DSY show that its sales of combed, ring-spun yarns declined significantly in fiscal 1995 (commencing in July 1994).

Available data also show that DSY incurred losses on its sales of combed yarns during fiscal 1994, while DYC was making a profit on its carded yarns on significantly lower average selling prices. Lastly, available sales data show that DSY's most recent selling prices for combed, ring-spun yarns are more than twice DYC's 1994 average selling prices for carded, open-end spun yarns and also much higher than Kute-Knit's landed cost for the subject yarns.

In light of the evidence, the Tribunal cannot conclude that combed, ring-spun yarns are still produced in Canada. From evidence on the record, the Tribunal believes that yarn producers are concentrating on the production of carded, open-end spun yarns which can be produced profitably and for which there is strong demand. In this regard, the Tribunal notes that DYC is supplementing its domestic production with imports of carded, open-end spun yarns.

There remains for the Tribunal to consider whether or not carded yarns and combed, open-end and air-jet yarns are substitutable for combed, ring-spun yarns. Information on file indicates that three companies

in Canada produce carded yarns using the open-end method. These are DSY, DYC and Glendale. DSY also produces certain combed yarns.

As noted above, the open-end method feeds slivers directly into high-speed spinners to produce low-cost yarns that may have had some degree of combing. Open-end and air-jet spinning are both newer processes which produce yarns at lower cost, but of lesser quality because of the particular properties and qualities emanating from the ring spinning method. The more traditional ring spinning method, because of the additional combing, drawing and roving processes required, is more costly, but it imparts certain qualities and characteristics to yarns, and to fabrics made from those yarns, that are not available from other processes. These characteristics have been described as better appearance, more softness and evenness, less shrinkage, less “pill” and better “hand,” among others.

It is the opinion of the Tribunal that there are significant quantifiable and qualitative differences between these various yarns. In the absence of such differences, knitters would certainly opt for combed, open-end or air-jet yarns or for carded yarns, all of which are less expensive. The inherent qualities of combed, ring-spun yarns appeal to those knitters interested in making high-quality products. The Tribunal believes that carded yarns and combed, open-end and air-jet yarns are not substitutable for combed, ring-spun yarns.

The CTI contended that the price differential between combed yarns and carded yarns is similar, in magnitude, to the current MFN rate of 10 percent, although it conceded that combed yarns cost more to produce and are sold at higher prices. That may be so for certain combed, open-end spun yarns, but the Tribunal is of the view that, based on available information, the price differential between combed, ring-spun yarns and other combed and carded yarns is significantly greater than the current MFN tariff. Knitters now using carded and combed, open-end or air-jet yarns are therefore not likely, in the view of the Tribunal, to switch to combed, ring-spun yarns if the tariff is removed.

In summary, the Tribunal is satisfied, on the basis of the evidence, that carded yarns are not substitutable for combed, ring-spun yarns.

The primary direct benefits of granting the proposed tariff relief, based on the projected level of imports of combed, ring-spun yarns, would amount to more than \$250,000 annually, if the subject yarns were all dutiable at the MFN rate of duty. Other than the corresponding duty revenues foregone by the government, the Tribunal does not believe that there would be any direct commercial costs of providing the tariff relief. In summary, the Tribunal concludes that the net economic benefits of providing the tariff relief in this case will be positive.

The Tribunal notes that DSY has recently made a major investment in new open-end spinning equipment that is capable of producing “combed,” polycotton, blended yarns, but that the production volume of “combed” yarns from this equipment, and the air-jet process currently in place, is very limited. Moreover, the Tribunal is not persuaded that the yarns produced by this equipment are presently of substitutable quality for combed, ring-spun yarns. Given that these newer processes are not subject to the inherent limitations of ring spinning in respect of production speed, efficiency and productivity, it may be that, at some time in the future, combed yarns produced by this equipment will increase in quantity and quality and become substitutable for imported ring-spun yarns. Should this occur, it is open to DSY, or any other producer, to

request the commencement of an investigation under subsection 18(1) of the Tribunal's Textile Reference Guidelines for the purpose of recommending an amendment of the order of the Governor in Council providing tariff relief, prior to its expiry.

In order to provide a degree of stability for Kute-Knit and other users of combed, ring-spun yarns, the Tribunal recommends that any tariff relief in this case be granted for a period of three years.

With regard to Kute-Knit's request for retroactive tariff relief, the Tribunal does not believe that there are any extraordinary circumstances warranting such a recommendation.

RECOMMENDATION

In light of the foregoing and the evidence on the record, the Tribunal hereby recommends to the Minister that the customs duty on importations of combed, ring-spun, polycotton, blended yarns be removed for a three-year period.

Raynald Guay
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Presiding Member

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