



**REPORT TO
THE MINISTER OF FINANCE**

**REQUESTS FOR TARIFF RELIEF BY
CHÂTEAU STORES OF CANADA LTD. AND
HEMISPHERE PRODUCTIONS INC.
REGARDING
ARMANI GABARDINE**

SEPTEMBER 19, 1995

**REQUEST NOS.: TR-94-011
AND TR-94-019**

**CHÂTEAU STORES OF CANADA LTD.
AND HEMISPHERE PRODUCTIONS INC.**

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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 March 6 and 28, 1995, the Tribunal received requests from Château Stores of Canada Ltd. (Le Château) and Hemisphere Productions Inc. (Hemisphere), respectively, of Montréal, Quebec, for the permanent removal of the customs duty on importations, from all countries, of Armani gabardine, a high-twist woven fabric made of 65 percent polyester and 35 percent rayon, of a width of 55/56 in. and a weight of approximately 255 g/m², with a dry hand feel and a high degree of drapeability, for use in the production of ladies' vests, pants, skirts, dresses, shorts and blazers and men's vests, pants and jackets (the subject fabric).

On April 28, 1995, the Tribunal, being satisfied that the requests were properly documented, issued a notice of commencement of investigation, which was distributed and published in Part I of the May 6, 1995, edition of the Canada Gazette.²

As part of the investigation, the Tribunal's research staff sent questionnaires to potential producers of fabrics identical to or substitutable for the subject fabric. Questionnaires were also sent to known users of fabrics identical to or substitutable for the subject fabric and to two known importers of the subject fabric. A letter was sent to the Department of National Revenue (Revenue Canada) requesting information on the tariff classification of the subject fabric, and samples were provided for laboratory analysis. Letters were also sent to a number of other government departments requesting information and advice.

A staff investigation report, summarizing the information received from these departments, Le Château, Hemisphere and other firms that responded to the questionnaires, was provided to the parties that had filed notices of appearance for this investigation. These parties are: Le Château, Hemisphere, the Canadian Textiles Institute (CTI), Tribal Sportswear Inc., Doubletex Inc. (Doubletex), General Textiles Ltd. (General) and K.T.H. Sportswear Industries Ltd.

Doubletex and the CTI filed submissions with the Tribunal, to which only Le Château provided a response. A public hearing was not held for this investigation.

PRODUCT INFORMATION

The name "Armani gabardine"³ is an internal industry name which was created simply to identify the fabric. The users of this fabric do not use the "Armani" name in advertising or in any public promotional way.

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

2. Vol. 129, No. 18 at 1489.

3. Revenue Canada's analysis of the samples determined that the subject fabric is, in fact, not a gabardine but a satin weave fabric.

According to Revenue Canada, the subject fabric is classified for customs purposes under tariff item No. 5515.11.00.00 of Schedule I to the *Customs Tariff*.⁴ It is dutiable at 20.5 percent ad valorem under the MFN tariff, subject to the GPT; at 20.2 percent ad valorem under the BPT; at 7.5 percent ad valorem under the U.S. tariff; and at 20.0 percent ad valorem under the Mexico tariff.

Revenue Canada analyzed the subject fabric and confirmed that it is not a gabardine or twill weave fabric,⁵ as stated by Le Château and Hemisphere. Instead, it was determined that the subject fabric is a five-harness satin weave fabric, woven from high-twist blended yarns of 65 percent by weight polyester staple fibres and 35 percent by weight viscose rayon staple fibres, of a width of 140 to 142 cm. The two samples (one submitted by Le Château and the other submitted by Hemisphere) sent to Revenue Canada weighed 264 g/m² and 266 g/m², respectively.

Revenue Canada suggested the following product description in the event that tariff relief is granted:

Five-harness satin weave fabric, woven from high-twist blended yarns of 65 percent by weight polyester staple fibres and 35 percent by weight viscose rayon staple fibres, of a width of 140 to 142 centimetres and ranging in weight from 256 g/m² to 275 g/m², for use in the production of ladies' vests, pants, skirts, dresses, shorts and blazers and men's vests, pants and jackets.

The domestic textile industry submitted its own analysis of samples of the subject fabric. It reported similar findings to those reported by Revenue Canada. In addition, the CTI suggests that, in the event tariff relief is granted, the formal definition should include a definition of "high-twist." Specifically, the subject fabric exceeds 1,000 turns per metre. Discussions with Revenue Canada confirmed that a high-twist yarn, in this case, should have over 960 turns per metre.

Le Château uses the subject fabric in the manufacture of ladies' vests, pants, skirts, dresses, and blazers, as well as men's vests, pants and jackets. The production process for the garments is performed at Le Château's production facilities, as well as at the premises of various sewing contractors. Le Château performs operations such as designing, making patterns and samples, and preparing, marking and cutting the fabric. The sewing contractors sew, assemble and prepare the garments to a finished state. The finished garments are then returned to Le Château for final inspection and distribution.

Hemisphere uses the subject fabric in the manufacture of ladies' blazers, pants, skirts, vests and shorts. However, none of the physical production of the garments is carried out by Hemisphere, which directly employs 11 people in design and administrative functions at its head office in Montréal. Hemisphere contracts the cutting and sewing operations to Canadian contractors. These contractors cut the fabric to the required sizes and shapes, and sew the cut pieces into finished garments. The finished garments are then returned to Hemisphere for distribution to private label accounts.

The apparent Canadian market for the subject fabric and alleged substitutable fabrics in 1994 was estimated to be approximately 2.8 million linear metres. This estimate comprises the combined purchases of

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

5. Consoltex Inc. and Doubletex also submit that the subject fabric is not a twill weave fabric, but rather a five-harness satin weave fabric.

imports reported by the two known importers, Vogue Textiles Inc. and General, and the volume of sales of the alleged substitutable fabrics produced by Consoltex Inc. (Consoltex) and Doubletex.

Total Canadian imports of the subject fabric are estimated to be about 4.0 million linear metres in 1995, with a value for duty of approximately \$12.5 million. The expected imports of the subject fabric in 1995 represent an increase over 1994 of approximately 135 percent in volume and 127 percent in value. Historically, these imports have originated in Taiwan.

REPRESENTATIONS

The requests made by Le Château and Hemisphere are for the permanent removal of the customs duty under the MFN tariff. The estimated duty savings for the identified users of the subject fabric would amount to approximately \$1.1 million annually.

Le Château alleges that the Canadian consumer influences its decision to import the subject fabric. It believes that the current and long-term potential volumes of sales of this staple fabric should encourage the domestic textile producers to manufacture a similar high-twist woven fabric. Le Château believes that this fabric will be in demand for many years to come, unlike certain other fashion fabrics.

Le Château believes that it is important for Canadian fabric suppliers to commit to more research and development and to stay ahead of foreign competition in order to keep the business in Canada. Le Château also believes that the textile industry must respond to the demands of the Canadian consumer. Le Château contends that, in view of the submissions filed by Consoltex and Doubletex which demonstrate their "current eagerness and willingness and confidence to now develop [the subject] fabric," temporary tariff relief should go into effect "until such a time that the 'Armani Gabardine' fabric is made available domestically."

Hemisphere also submits that a high-twist woven fabric substitutable for the subject fabric is not available in Canada. It argues that the company must be in a position to continually provide updated fashion trends to its customers. Hemisphere acknowledges that it is generally in its best interest to buy fabrics domestically whenever possible in order to avoid paying duty, exchange rates, brokerage fees, etc. If tariff relief is granted, Hemisphere anticipates increased sales, lower selling prices and increased production capabilities.

The CTI represents Canadian manufacturers of textiles. It opposes the request on the basis that substitutable fabrics are produced in Canada. The CTI contends that domestic producers would suffer lost sales, price pressures, declines in production and employment, and an erosion of margins and profits.

In its final submission, following receipt of the staff investigation report, the CTI submits that the Tribunal's staff underestimated the economic impact of tariff relief on the domestic textile industry. It argues that a change in the tariff for textiles has a diminishing relative impact at successive levels of the industrial structure for manufacturers of textiles and textile products. Therefore, the cost to the textile manufacturer has a much higher relative impact compared to the cost/benefit resulting to the garment manufacturer.

Noting that the Tribunal's staff estimated costs associated with the cancellation of twill weave fabric production in terms of gross margin, Consoltex argues that the real life impact would extend beyond twill weave fabric production to the production of other fashion fabrics, sold to ladies' apparel manufacturers, that

compete directly with the subject fabric. It also argues that the impact would extend beyond gross margin and would include loss of employment at Consoltex, as well as a loss of sales, production and employment for yarn suppliers, namely, Dominion Specialty Yarns.

The CTI argues that it is unrealistic to assume that 100 percent of the duty removed would be secured as savings by textile users in a market where exporters and retailers are striving to improve margins. Further, it is unrealistic to assume that users of imported textiles will capture every duty dollar foregone by the government. It is more probable that the foreign exporter will succeed in capturing a portion of the tariff relief. The CTI states that, similarly, it is unrealistic to postulate a zero cost to the Canadian textile industry, especially since there are industry submissions to the Tribunal which demonstrate that they would actually incur certain costs.

Consoltex notes that the tariff reductions implemented as a result of the Tribunal's 1990 inquiry into textile tariffs,⁶ the tariff reductions negotiated under the *Canada-United States Free Trade Agreement*⁷ and the *North American Free Trade Agreement*,⁸ and tariff concessions and quota eliminations to which Canada agreed at the Uruguay Round of Multilateral Trade Negotiations all provide for reducing rates of duty on imported textiles over a period of time. Consoltex argues that this time allowance is necessary for Canadian textile manufacturers to adjust to the lower levels of protection and increased competition.

Doubletex submits that it has an important and growing business supplying the apparel industry with fabrics woven from high-twist yarns. It argues that this business will be jeopardized if tariff relief is granted. The subject fabric would land at a price which would put it in direct competition with certain fabrics woven from high-twist yarns which Doubletex currently produces and sells to various ladies' apparel manufacturers.

Doubletex contends that the Tribunal's staff underestimated its costs if tariff relief were granted. It argues that costs would equate to the total loss of revenue on the fabrics that Doubletex identified as being substitutable for the subject fabric.

The Department of Foreign Affairs and International Trade informed the Tribunal that Canada currently maintains a quota restraint on polyester/rayon woven fabric, comprised of blends of polyester staple and rayon staple or filament fibres, imported from Taiwan. The bilateral agreement, which provides for this restriction, between the Government of Canada and the Taiwan Textile Federation has been in place since 1987. The quota limit on these fabrics was implemented to protect Canadian manufacturers from large volumes and low prices of exports from Taiwan. The 1994 original restraint level for polyester/rayon fabric of item 37a of the Canada/Taiwan textile agreement was set at 1,822,989 kg, with an annual growth rate of 5 percent. The annual utilization of the adjusted 1994 restraint level for item 37a, fixed at 2,023,518 kg, was 1,944,834 kg, or 96 percent.

A decision to grant tariff relief would allow interested parties to apply for ex-quota treatment. In this regard, Doubletex submitted that, despite opposing the tariff relief, it is seeking ex-quota treatment on imports of greige "Armani gabardine."

6. *An Inquiry into Textile Tariffs*, Reference No. MN-89-001, February 1990.

7. *Canada Treaty Series*, 1989, No. 3 (C.T.S.).

8. Done at Ottawa, Ontario, on December 11 and 17, 1992, at Mexico, D.F., on December 14 and 17, 1992, and at Washington, D.C., on December 8 and 17, 1992 (in force for Canada on January 1, 1994).

Revenue Canada has indicated that there would be no additional costs, over and above those already incurred by it, to administer the tariff relief, should it be granted. The domestic textile producers question the accuracy of this statement and argue that, if this is true, there could be considerable abuse of a new provision. Discussions between the Tribunal's staff and Revenue Canada confirmed that, as part of its standard operating practice, items which are granted special consideration are sent to Revenue Canada's laboratory for analysis and confirmation of proper classification for every new importer seeking the special rate. For enforcement purposes, items are thereafter randomly sent for analysis and confirmation of proper classification.

ANALYSIS

In this case, the Tribunal is concerned with the issues of, first, whether an identical or substitutable fabric is produced in Canada and, second, the impact of granting the tariff relief on the interested domestic producers.

The question of "fabric substitutability" is not a new issue and has been the cause of friction between the textile and clothing industries for many years. In addressing the issue of substitutability in this case, the Tribunal paid attention to a number of factors, including the following.

The **technical description** of any two fabrics should be the first level of screening when trying to establish whether fabrics are substitutable. For example, the Tribunal would find it difficult to accept claims made by textile producers that a man-made woven fabric is substitutable for a non-woven fabric or that a polycotton fabric is substitutable for a polyester/rayon fabric. In other words, the technical composition and description must generally be in the same category.⁹

In this case, the subject fabric is woven from high-twist yarns, whereas Consoltex, a large domestic textile producer, does not supply a fabric woven from high-twist yarns. The evidence shows that the desired characteristics of drapeability and feel of the subject fabric are created because of the high-twist yarns. This seems to support the arguments made by Le Château and Hemisphere that a direct substitute is not available.

Market acceptance is another factor to consider when analyzing substitutability. Although two fabrics may have similar technical descriptions, tariff classifications and certain other physical or end-use characteristics, consumers may perceive these fabrics to be different and, therefore, not directly substitutable. In this case, the historical and projected sales of the subject fabric demonstrate that there is a demand and identified market acceptance for the subject fabric which are quite separate and distinct from the demand for alleged substitutable domestic fabrics.

9. The Harmonized Commodity Description and Coding System of tariff classification is directly related to the technical description of a fabric. Theoretically, many fabrics could be produced which would have slightly different physical characteristics from those of the subject fabric, but which would still fall under the same 10-digit classification number as that of the subject fabric. These different physical characteristics could be as simple as slight variations in yarn denier, twist factor or fabric weight. Further, numerous other fabrics could be produced which would have only slightly different physical characteristics from those of the subject fabric, but which would fall under a different 10-digit classification number from that of the subject fabric.

Price is linked to market acceptance. Consumers of certain fabrics are willing to pay more for characteristics that they feel are available in one fabric but not in another. Therefore, evidence which shows that one fabric commands a different price from another would tend to indicate to the Tribunal that the two fabrics are not direct substitutes, even though, functionally, the fabrics are used in the same end product, i.e. skirts or pants. The Tribunal, however, recognizes that there are many reasons for the prices of any two very similar products to differ. Therefore, the price ranges within which fabrics and end products fall are other indicators of the potential substitutability of one fabric for another. The Tribunal considers a marginal difference in price not to impact on the potential substitutability of fabrics. However, in this case, the landed price of the subject fabric is notably higher than the price of domestic fabrics. Further, similar end products made up of the subject fabric and a domestic fabric, for example, skirts, are priced at different points. The fact that domestic garment manufacturers are willing to pay more for a particular fabric tends to support the argument that domestic fabrics are not directly substitutable for the subject fabric in the market in which they compete.

Ability to supply is yet another factor considered by the Tribunal. The Tribunal does not give much weight to the arguments put forth by domestic textile producers that they can produce identical or substitutable fabrics as a reason not to grant tariff relief.¹⁰ The Tribunal needs more than mere assertions of the potential ability to supply a certain fabric. It also needs evidence that domestic producers have actually furnished domestic users with an identical or substitutable product or that they are in the process of establishing the supply of a substitutable fabric for domestic users. Further, the domestic textile producers should be able to demonstrate the ability and willingness to supply both large and small quantities as required, on acceptable commercial terms.

In this case, Le Château submits that it approached Consoltex several times for the development of a high-twist woven fabric similar to the subject fabric. Consoltex, it is alleged, responded by acknowledging that it does not have a domestic supply of high-twist yarns and that it anticipates problems importing high-twist yarns.¹¹

Doubletex, on the other hand, claims that it produces a number of substitutable fabrics woven from high-twist yarns. However, the Tribunal notes that none of the fabrics identified by Doubletex has the same construction as the subject fabric (65 percent polyester staple fibres and 35 percent rayon staple fibres). Further, the fabrics do not fall within the weight range of 256 g/m² to 275 g/m², as identified by Revenue Canada. In addition, Doubletex acknowledges that its current fabrics are not direct substitutes because it submitted to the Tribunal that it wants to add the subject fabric to its line of available fabrics.

The Tribunal accepts that Consoltex and Doubletex produce a broad range of fabrics that are sold in Canada to garment manufacturers of ladies' and men's wear and that compete with the subject fabric in the marketplace. The Tribunal is of the view that they produce many fabrics which, to a limited degree,¹² are substitutable for the subject fabric and that these fabrics are sold to Canadian producers of certain ladies' and

10. See Report to Minister of Finance: Request for Tariff Relief by Hemisphere Productions Inc. Regarding 100% Polyester Herringbone Woven Fabric, Canadian International Trade Tribunal, Request No. TR-94-005, June 22, 1995.

11. If domestic textile producers are required to import certain high-twist yarns because they are not available in Canada, they can also request tariff relief for importations of yarns.

12. A limited degree of substitutability in terms of end use and functionality of the fabric.

men's apparel. The Tribunal also recognizes that, as a result of this degree of fabric substitutability, there may be some negative impact of tariff relief on profitability, costs and wholesale prices.

However, the Tribunal also notes that, and puts much weight on, submissions made by both Consoltex and Doubletex in which they state that they are in the process of developing a domestic supply of a high-twist woven fabric with the same features, qualities and market acceptance as the subject fabric. The Tribunal believes that the industry's recognition of the need to produce and supply this type of high-twist woven fabric acknowledges and supports the fact that the current domestic fabrics are not direct substitutes for the subject fabric.

The primary direct benefits of granting the tariff relief, based on the historical level of imports of the subject fabric and the projections made by the users of the subject fabric, would amount to just over \$1.1 million per annum, if the subject fabric were dutiable under the MFN tariff and assuming no further changes to the import volumes and prices as estimated for 1995.

In addition to these benefits, there would be certain costs associated with the tariff relief, although these costs are difficult to assess with precision. Based on the information submitted to the Tribunal, which alleges a high degree of substitutability, the Tribunal's staff estimates that costs may range from \$1.1 to \$4.5 million. However, the Tribunal does not concur with this high level of substitutability (i.e. that a broad range of fashion fabrics, in addition to twill weave and high-twist satin weave fabrics, would also be affected by a reduction in tariffs). Overall, the Tribunal is of the view that the estimated benefits provided by the tariff relief will exceed, by a high margin, any costs that may be incurred by the industry as a result of granting the tariff relief.

The Tribunal believes that the domestic garment manufacturers using the subject fabric should be afforded the opportunity to become more competitive with imports of similar garments. In this regard, a reduction in costs through tariff relief would advance the relative competitive position of these garment manufacturers.

Notwithstanding the arguments put forth for a broader degree of substitutability of the domestic fabrics, it is the Tribunal's view that the fashion industry operates on a lower degree of substitutability and, therefore, searches for, and insists on, new fabrics which are, or are soon expected to be, demanded by consumers. Canadian garment manufacturers always have the option of searching the world market for fabrics to meet the demands of their customers. If these fabrics are not available in Canada, tariff relief can be considered.

Based on the evidence provided to the Tribunal, the subject fabric appears to be more than a seasonal fashion fabric. Le Château has demonstrated that the market demands the subject fabric. The projected sales of the subject fabric should encourage the domestic textile industry to meet the needs of its customers and supply a similar high-twist woven fabric.

Finally, the CTI stated that, should the Tribunal grant tariff relief in this case, it would "fly in the face of the Tribunal's own conclusions in MN-89-001 (Textile Tariffs)." The Tribunal's conclusions in Reference No. MN-89-001 were in reference to three major groups of inputs used by the textile industry, that is, fibres, yarns and fabrics. The terms of reference guiding the Tribunal in this case necessarily focus the requests for tariff relief on very specific textile inputs for particular end uses. Therefore, the Tribunal is obliged, by the

terms of the textile reference, to focus on specific requests and to make its recommendations exclusively in that context.

In summary, the Tribunal finds that the domestic fabrics provide a limited degree of substitutability for the subject fabric and that the net economic benefits of granting the tariff relief, in the short term, will be positive.

RECOMMENDATION

In light of the foregoing, the Tribunal hereby recommends to the Minister that the customs duty on importations of five-harness satin weave fabric, woven from high-twist (over 960 turns per metre) blended yarns of 65 percent by weight polyester staple fibres and 35 percent by weight viscose rayon staple fibres, of a width of 140 to 142 cm and ranging in weight from 256 g/m² to 275 g/m², for use in the production of ladies' vests, pants, skirts, dresses, shorts and blazers and men's vests, pants and jackets, be removed for a period of two years.

Given the statements of commitment made by domestic textile manufacturers to produce and supply a high-twist woven fabric with qualities similar to those of the subject fabric, it is open to Consoltex, Doubletex and any other producer, when such a fabric is available in Canada, 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. Le Château also recognizes the willingness of the domestic textile producers to supply a similar high-twist woven fabric and supports their efforts, suggesting that the tariff relief should be limited to a time when an acceptable substitute is available in Canada.

Arthur B. Trudeau

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