CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

# REPORT TO THE MINISTER OF FINANCE

## REQUEST FOR TARIFF RELIEF BY PEERLESS CLOTHING INC. REGARDING WOVEN FABRICS OF FLAX

**JANUARY 17, 1996**

PEERLESS CLOTHING INC.

REQUEST NO.: TR-94-012

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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, 1995, the Tribunal received a request from Peerless Clothing Inc. (Peerless) of Montréal, Quebec, for the immediate and permanent removal of the customs duty on importations of woven fabrics of flax containing 50 percent or more but less than 85 percent by weight of flax for use in the production of men's fine tailored suits, sports coats, vests, trousers and walking shorts.

On April 21, 1995, the Tribunal, being satisfied that the request was properly documented, issued a notice of commencement of investigation, which was distributed and published in the April 29, 1995, edition of the Canada Gazette, Part I.[2]

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

A staff investigation report, summarizing the information received from these departments, Peerless and firms responding to the Tribunal's questionnaires, was provided to the parties that had filed notices of appearance for this investigation.[3] These parties are Peerless, S. Cohen Inc. and the Canadian Textiles Institute (CTI).[4]

The CTI filed a submission with the Tribunal, to which Peerless filed a response. A public hearing was not held for this investigation. The Tribunal recognizes that the CTI's submission was filed late. Nevertheless, the Tribunal has decided, with some reluctance, to accept the CTI's submission, as it finds the information significantly important to its investigation, and its late acceptance does not unduly prejudice the interests of Peerless and others. The Tribunal attaches great importance to the need for parties to an

1. R.S.C. 1985, c. 47 (4th Supp.).
2. Vol. 129, No. 17 at 1276.
3. The distribution of the staff investigation report was scheduled for June 19, 1995, but had to be postponed to August 18, 1995, because of delays caused from not being supplied with appropriate samples of the woven fabrics of flax. Subsequent delays caused by parties prevented the Tribunal from reaching its objective of issuing its recommendation within 120 days from commencement of the investigation.
4. The CTI represented Canadian textile producers that opposed the requested tariff relief. In this case, the textile producers are identified as: Cleyn & Tinker Inc. of Huntingdon, Quebec; West Coast Woollen Mills (1986) Ltd. of Vancouver, British Columbia; and Consoltex Inc. of Montréal.

investigation to meet all due dates, and its decision in this case should not be seen as a precedent in future cases.

## PRODUCT INFORMATION

At the beginning of the investigation, Peerless agreed to change the scope of the request to woven fabrics of flax containing more than 50 percent but less than 85 percent by weight of flax for use in the production of men's fine tailored suits, sports coats, vests, trousers and walking shorts (the subject fabrics) to meet the classification requirements of Schedule I to the *Customs Tariff*.[5]

The subject fabrics are imported from countries benefiting from the MFN tariff, including Italy, France, Spain and Taiwan, and from those benefiting from the GPT, such as Hong Kong.

Revenue Canada advised the Tribunal that a sample of the subject fabrics submitted by Peerless contained 64 percent by weight of flax and 36 percent by weight of viscose rayon staple fibres and that, as such, it is classified under tariff item No. 5309.29.00 of Schedule I to the *Customs Tariff*. In 1995, goods classified under tariff item No. 5309.29.00 were dutiable at 16.9 percent *ad valorem* under the MFN tariff; at 14.0 percent *ad valorem* under the GPT; at 6.4 percent *ad valorem* under the U.S. tariff; and free under the Mexico tariff.

Peerless cuts and sews the subject fabrics into certain men's apparel at its plant in Montréal. Ninety-five percent of its production of that apparel is destined for the U.S. market. Other Canadian users report cutting and sewing the subject fabrics to produce men's apparel, including men's shirts, and women's apparel.

The Tribunal's investigation has revealed that there is no Canadian production of the subject fabrics. However, Cleyn & Tinker Inc. (Cleyn & Tinker) produces fabric blends which it considers to be substitutable for the subject fabrics. Some of the blends contain up to 36 percent by weight of flax. To date, Cleyn & Tinker has not sold these flax blends in Canada for the specific end use described in the request. Similarly, West Coast Woollen Mills (1986) Ltd. (West Coast Mills) produces some woven fabrics containing flax, but sells them for the manufacture of women's apparel. A third Canadian producer, Consoltex Inc. (Consoltex), which does not currently produce the subject fabrics, stated that it had the capability of doing so. As a result, the Canadian market for the subject fabrics is calculated on the basis of imports.

Users and importers of the subject fabrics forecast total imports, in 1995, to be under 100,000 linear metres. The majority of these imports originated in countries benefiting from the MFN tariff. The apparent market for the subject fabrics used by Canadian producers of certain men's apparel for sale in Canada, in 1995, is estimated to be between 10,000 and 15,000 linear metres. The remainder of the subject fabrics are cut and sewn into certain men's apparel which is exported to the United States.

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

## REPRESENTATIONS

### Producers of Certain Men's Apparel

Peerless, established in 1919, is Canada's largest producer of men's fine tailored apparel. In 1994, Peerless obtained an exclusive licence to market two well-known U.S. brand names, "Chaps" and "Ralph" by Ralph Lauren, using the subject fabrics to produce a casual (i.e. less pressed look) line of apparel.

Peerless's request raised a number of issues with respect to its need for tariff relief, including questions of tariff policy and the non-availability of the subject fabrics from Canadian producers. The purpose of the request is to enable Peerless to take advantage of fashion trends towards the use of flax in men's apparel, especially in the United States, and to remain competitive with U.S. producers which can import the subject fabrics at very low rates of duty.[6]

On this last point, Peerless stated that the gradual elimination of the Duty Drawback Program between January 1, 1996, and January 1, 1998,[7] combined with tariff rate differentials between Canada and the United States for the subject fabrics, will place it at a price disadvantage with its U.S. competitors if tariff relief is not granted. Peerless added that the total amount of duties payable will be magnified as they move through the price markups of the apparel sector. As a result, Peerless argued that not only would it not be competitive in the U.S. market but it would also be "unable to match (in Canada) the pricing of imports of similar goods from the United States."

For Peerless, the linen look is in fashion, and it has to produce men's apparel with that appearance. Linen fabrics are as distinct from other fabrics, such as wool, as wool fabrics are distinct from cotton or silk fabrics. This is true, individually, for all of these four fabrics. A woven linen fabric wrinkles, takes colour well and breathes. As other fibres are added to the composition of the woven fabric, for example, viscose, some of the distinctive characteristics of linen are lost. Some customers prefer 100 percent linen garments because they eschew wearing anything synthetic. Other customers, who are less discriminating but still want the linen look, accept garments made from fabrics containing mostly flax fibres, such as the subject fabrics.

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6. The subject fabrics are dutiable at 16.9 percent *ad valorem* under the MFN tariff in Canada and at 2.7 percent *ad valorem* under the MFN tariff in the United States in 1995 and will be reduced to 14.0 percent and free, respectively, in 2004 at the end of the staging of the tariff concession under the Uruguay Round of Multilateral Trade Negotiations.

7. For Canadian-U.S. trade, a "duty refund system" will replace the Duty Drawback Program on January 1, 1996. The refund will be equivalent to the lesser of: (a) the duty paid on a fabric imported to make garments; or (b) the duty paid on the finished garments when exported to the United States. This means that the duty refund system will be phased out at the same pace as the NAFTA tariff-free access is phased in. Full duty drawbacks will, nevertheless, continue to apply indefinitely to Canadian apparel exports to the United States that are traded at full MFN rates of duty after tariff preference levels have been fully utilized. For apparel exported to non-NAFTA countries, duty drawbacks will continue to apply indefinitely.

Peerless and six other Canadian manufacturers[8] of men's apparel that support Peerless's request either implicitly or explicitly indicated that they had been unable to find identical, substitutable or similar fabrics produced in Canada.

The estimated duty savings for Peerless and the other identified users of the subject fabrics would amount to between $140,000 and $160,000 annually, less any duty drawbacks.

**Textile Weavers**

In its preliminary submission, the CTI questioned a number of the statements made by Peerless on the subject of the non-availability of identical or substitutable fabrics and Canadian tariff policy, including tariff rate differentials between Canada and the United States.

In its submission following receipt of the Tribunal's staff investigation report, the CTI commented on the Canadian textile industry, in general, and on Cleyn & Tinker, in particular, as being capable of producing, on demand, a broad variety of fabrics, including flax blends, which are market substitutable for the subject fabrics. The CTI added that the industry depends upon the statutory and scheduled tariffs for its well-being.

The CTI reiterated some of the observations contained in its preliminary submission, namely, that men's apparel of flax blends benefits from far lower U.S. MFN rates of duty than does men's apparel generally and that this tariff advantage is enhanced by less onerous NAFTA rules of origin for such apparel. As far as the CTI is concerned, Peerless has not shown why these existing advantages need to be augmented by the further artificially created advantage of duty-free tariff treatment for offshore fabrics. Moreover, the CTI advanced that granting the request will endanger the margins, viability and production of certain fabrics now made in Canada. The CTI also argued that NAFTA brings with it not only export opportunities but also certain obligations. These obligations can be described as promoting trade within North America, which a permanent removal of the tariff will forever discourage.

In the commercial benefits and costs section of the staff investigation report, the Tribunal presented three possible scenarios.[9] The CTI described the first scenario as being unrealistic, as it calculates the price effect of tariff reduction on each fabric in isolation without consideration of the effect on similar fabrics. While the second scenario considered the impact of a price reduction on Cleyn & Tinker's production of

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8. The six firms are: Lou Myles Disegnatore of Vaughan, Ontario, and SFI Apparel Corporation of Montréal, which currently import the subject fabrics for use in their production of apparel; The Coppley Noyes & Randall Limited of Hamilton, Ontario; S. Cohen Inc. of Montréal; Ballin Inc. of Montréal; and Freed & Freed International Ltd. of Winnipeg, Manitoba.

9. The first scenario described the benefits and costs of a tariff reduction for only fabrics identical to the subject fabrics, which, in this case, included data for only the subject fabrics. The second and third scenarios considered the production of alleged substitutes by the domestic producer, Cleyn & Tinker. The second scenario used a calculation of costs based on losses of gross margin resulting from lower prices, while, in the third scenario, costs were estimated to be the loss of contribution margin and profits should a portion of the production of all substitutable blends, including those with a flax content, be discontinued. These three scenarios gave a range of the impact of granting the tariff relief requested from a net benefit of $160,000 to a net cost which the CTI describes as substantial.

substitutable fabrics, the CTI advanced that it did not consider the opportunity loss of fabrics which might be made in the future. The CTI also took issue with the underlying logic of this scenario. First, it did not consider the loss of customs revenue and, second, it assumed that the margins lost by textile producers due to tariff removal would be exactly offset by benefits to users. The CTI believed that the third scenario was the one that came to grips with reality, in that the requested tariff removal would cause production of certain fabrics to cease in Canada. It pointed out that the magnitude of the net commercial cost would be greater than the net commercial benefit set out in either the first or second scenario.

Accordingly, for all of these reasons, the CTI took the position that the requested tariff relief should not be granted.

**Peerless's Response**

In its response to the CTI's submission, Peerless started by reviewing some of the main points of the staff investigation report from a point of view of the product description, availability and substitutability, the economic impact of granting the tariff relief and tariff issues.

Peerless then proceeded to a detailed response to the submission, firstly, by noting that, although the CTI submitted that the textile industry has the capability to produce other fabrics on demand for the specific end use and that, in that sense, Canadian fabrics are market substitutes for the subject fabrics, the industry has not actually produced the subject fabrics. Moreover, Consoltex itself stated that it could not profitably produce each and every fabric desired by all apparel manufacturers. Secondly, as to market acceptance, Peerless argued that the fact that Canadian textile producers make fabrics that are used in the production of men's suits does not mean that such suits are "marketplace substitutes" for flax-rich suits (i.e. made from the subject fabrics). For example, a wool-rich suit is not a substitute for a flax-rich suit.

Among the other points of contention raised by Peerless were the following:

- The lower U.S. rate of duty on men's apparel is not an advantage, as stated by the CTI. Furthermore, it is the asymmetrical rates of duty on the subject fabrics, not on the final products, which are at issue.

- The request does not seek "another advantage," as asserted by the CTI, but is merely asking that the status quo be maintained.

- Since the duty drawback currently results in the subject fabrics entering virtually duty-free, there is no basis for the CTI to assert that the request "endangers the margins, viability and production of certain fabrics now made in Canada."

- The second and third scenarios, in the commercial benefits and costs section of the Tribunal's staff investigation report, operate on the assumption that substitutable fabrics are available from Canadian production, but this assumption has not been met or satisfied. There is absolutely no evidence of sales of substitutable fabrics and, as such, there would be no cost to the domestic textile industry should tariff relief be granted.

Peerless concludes that, if tariff relief on flax-rich fabrics is not granted, it will not only suffer decreased profitability but, most importantly, lose the ability to make any sales at all.

**Departments**

The Department of Foreign Affairs and International Trade informed the Tribunal that Canada currently maintains quota restraints on polyester filament woven fabrics and combed wool woven fabrics imported from a number of countries. This coverage includes woven fabrics of flax of subheading No. 5309.29, mixed mainly or solely with polyester filaments or combed wool, including fine animal hair. It also pointed out that there were no imports from restrained sources of woven fabrics of flax, mixed mainly or solely with polyester filaments or combed wool, of subheading No. 5309.29.

The Department of Foreign Affairs and International Trade also informed the Tribunal that ex-quota entry on textile inputs would be considered where recommendation had been made by the Tribunal to remove the tariff on the basis of non-availability. Ex-quota treatment will be granted only in cases where it can be demonstrated that there is an extra charge for using products under quota or where goods are not available in Canada.

Revenue Canada 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.

## ANALYSIS

The Tribunal has considered all the facts made available by the investigation and the position of parties in the light of its terms of reference.

The first consideration is the determination of whether identical or substitutable fabrics are produced and sold in Canada. On the basis of the information submitted by domestic textile producers, the Tribunal recognizes that woven fabrics containing flax are currently produced in Canada by Cleyn & Tinker and West Coast Mills and, furthermore, that Consoltex has the potential to weave such fabrics. Moreover, the Tribunal acknowledges that Cleyn & Tinker is producing and selling fabrics containing up to 36 percent by weight of flax for use in the production of women's apparel, but not men's apparel. Furthermore, Cleyn & Tinker is on record as weaving fabrics with blends of fibres other than flax which it sells to producers of men's fine tailored suits, sports coats, vests, trousers and walking shorts. Another domestic producer, West Coast Mills, opted not to participate in this investigation since its interest is limited to fabrics that contain less than 50 percent by weight of flax that are used in the production of women's apparel. Accordingly, the Tribunal concludes that there is no current Canadian production of woven fabrics identical to the subject fabrics nor is it aware of any such production in recent years.

The fact that Consoltex has submitted a selling price quotation for the subject fabrics to the Tribunal is, nevertheless, in its view, indicative of potential domestic production. However, as noted in the terms of reference, in making its recommendations, the Tribunal must take into consideration such things as: industry sourcing patterns/market share; history of company sales; marketing and service history; repeat orders; delivery and other technical requirements; and investment and business plans of current and potential suppliers. In the case of current production, these elements are missing. As for potential production, the Tribunal is generally guided by evidence of investment and business plans indicating the imminent establishment of production. Neither Consoltex nor the CTI has demonstrated, to the satisfaction of the Tribunal, that any Canadian textile producers had concrete plans to enter into the production of the subject fabrics in the foreseeable future.

Thus, the question of substitutable, and not identical, fabrics is of prime importance to the Tribunal in arriving at its decision and must be dealt with prior to giving consideration to the commercial costs/benefits of granting the requested tariff relief. Therefore, the Tribunal must determine to what extent woven fabric blends of worsted wool, natural fibres or man-made fibres produced by Cleyn & Tinker, some containing 36 percent or less by weight of flax, can be considered to be substitutable for the subject fabrics. The fact that domestically produced blends are used to produce men's fine tailored suits, sports coats, vests, trousers and walking shorts or that flax blends are used to produce women's apparel attests to the commercial availability of the blends, but is only one of the factors which the Tribunal considers to be important in this case in assessing the substitutability of domestically produced fabrics with the subject fabrics. Also important, in its view, are the additional questions of whether such blends directly compete with the subject fabrics and whether there is market acceptance, as stipulated in the terms of reference. In the Tribunal's view, the fact that the market requires certain men's apparel to be made from fabrics containing more than 50 percent by weight of natural fibres, such as flax, which fabrics wrinkle, take colour well and breathe, leads the Tribunal to conclude that there is no current Canadian production of directly competing and market-accepted substitutable fabrics. Peerless resorted to imports of the subject fabrics in order to manufacture certain men's apparel for the U.S. market under the terms of its exclusive licence with Ralph Lauren. As noted in the Tribunal's recommendations in Request Nos. TR-94-011 and TR-94-019,[10] the fact that an identifiable separate market exists for flax-rich woven fabrics was a determining factor in considering that available domestic fabrics are not substitutable for the subject fabrics. Accordingly, from the points of view of technical description and market acceptance, the Tribunal concludes that there is no Canadian production of fabrics substitutable for the subject fabrics.

As noted by Consoltex in its submission, it does not and cannot profitably produce each and every fabric desired by all Canadian manufacturers. Consoltex and other Canadian producers make choices based on economic reasons to concentrate production in one area and forego production in another. This is not a question of ability to supply. In this case, the evidence indicates that Canadian producers have foregone the production of flax-rich woven fabrics, presumably because they can obtain greater returns and supply more markets from their production of other woven fabrics. It must be noted, however, that, while a market for the manufacture of certain men's apparel of flax has developed in Canada, were it not for the export market, the demand for Canadian flax-rich woven fabrics for the specific end use would be much more limited. This may explain why Canadian producers have not pursued the Canadian market for men's apparel made from flax-rich woven fabrics more assiduously.

In the circumstances, with no identical or substitutable fabrics produced in Canada, it is the question of economic benefits, and not costs, which needs to be addressed. The Tribunal accepts Peerless's argument that it is concerned with maintaining the status quo and not seeking an additional advantage. For the subject fabrics, customs duties collected in 1995 amounted to $160,000, of which 80 to 85 percent were subject to duty drawbacks on exports of men's apparel produced from the subject fabrics.

Thus, Canadian producers of men's apparel could remain competitive in export markets rather than have to absorb a Canadian duty of 16.9 percent in 1995, eventually dropping to 14.0 percent in 2004, when identical or substitutable fabrics are not available from Canadian production. Moreover, Peerless could maintain its export sales and increase its full-time work force.

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10. 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.

**RECOMMENDATION**

In light of the foregoing, the Tribunal hereby recommends to the Minister that the MFN customs duty on importations, from all countries, of

> woven fabrics of flax containing more than 50 percent but less than 85 percent by weight of flax of tariff item No. 5309.29.00 for use in the production of men's fine tailored suits, sports coats, vests, trousers and walking shorts

be removed indeterminately.

Should the Minister grant tariff relief pursuant to the Tribunal's recommendation and should a Canadian producer commence production of flax-rich woven fabrics, that producer may request the commencement of an investigation for the purpose of recommending the amendment of an order.

In the meantime, the Tribunal considers it important that tariff relief be granted to allow Canadian apparel exporters to maintain the same level of benefits available to them under the Duty Drawback Program so as to avoid additional input costs related to textile fabrics not available in Canada.

It is of interest to note that granting tariff relief as recommended will still leave tariff item No. 5309.29.00 to protect woven fabrics of flax containing 50 percent or less by weight of flax, including fabrics produced by Cleyn & Tinker and West Coast Mills. It is also worthy to note that woven fabrics containing 85 percent or more by weight of flax for use in the manufacture of apparel are accorded duty-free entry under Code 4390 of Schedule II to the *Customs Tariff* when imported from countries benefiting from the MFN tariff and the GPT.

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