

**REPORT TO
THE MINISTER OF FINANCE**

**REQUEST FOR TARIFF RELIEF BY
CANADIAN MILL SUPPLY CO. LTD.
REGARDING
BLEACHED COTTON GAUZE**

MAY 27, 1996

CANADIAN MILL SUPPLY CO. LTD.

REQUEST NO.: TR-95-036

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Tribunal Members: Arthur B. Trudeau, Presiding Member
Robert C. Coates, Q.C., Member
Lyle M. Russell, Member

Research Director: Réal Roy

Research Manager: Paul R. Berlinguette

Counsel for the Tribunal: David M. Attwater

Registration and
Distribution Officer: Claudette Friesen

Address all communications to:

The Secretary
Canadian International Trade Tribunal
Standard Life Centre
333 Laurier Avenue West
15th Floor
Ottawa, Ontario
K1A 0G7

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 July 19, 1995, the Tribunal received a request from Canadian Mill Supply Co. Ltd. (Canadian Mill) of Scarborough, Ontario, for the permanent removal of the customs duty on importations of bleached, plain weave gauze fabric, loosely woven from single yarns of cotton fibres and weighing not more than 100 g/m², for use in the manufacture of resin-coated wiping cloths (the subject fabric). Canadian Mill requested that the tariff relief be retroactive to January 1, 1994, or, alternatively, the date of the submission, namely, July 17, 1995.

On December 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 the December 30, 1995, edition of the *Canada Gazette*, Part I.²

As part of the investigation, the Tribunal's research staff sent requests for information to potential domestic producers of fabrics identical to or substitutable for the subject fabric. Requests for information were also sent to potential users and to a number of potential importers of the subject fabric. Two letters were sent to the Department of National Revenue (Revenue Canada) requesting information on the tariff classification of the subject fabric, and two 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, Canadian Mill and other interested parties, was provided to the parties that had filed notices of appearance for this investigation. These parties are Canadian Mill and the Canadian Textiles Institute (CTI).

A public hearing was not held for this investigation.

PRODUCT INFORMATION

Canadian Mill described the subject fabric as 100 percent cotton gauze woven fabric, plain weave, bleached, weighing not more than 100 g/m², for use in the production of resin-coated wiping cloths. Canadian Mill indicated in its request that the subject fabric was classified under classification No. 5208.21.00.10 of Schedule I to the *Customs Tariff*.³

Revenue Canada analyzed the two samples submitted by Canadian Mill and determined that the fabric is a bleached, plain weave "gauze" fabric, loosely woven from single yarns of cotton fibres. Revenue Canada confirmed that the subject fabric is classified under classification No. 5208.21.00.10.

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

2. Vol. 129, No. 52 at 4382.

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

The Revenue Canada laboratory report stated that the yarns of the first sample had a decitex per single yarn of approximately 124 in the warp direction and 169 in the weft direction. There were 79 yarns/10 cm in the warp direction and 47 yarns/10 cm in the weft direction. The fabric was found to weigh 20 g/m². With respect to the second sample, Revenue Canada determined that the yarns had a decitex per single yarn of approximately 165 in the warp direction and 170 in the weft direction. There were 165 yarns/10 cm in the warp direction and 151 yarns/10 cm in the weft direction. This fabric was found to weigh 56 g/m². Revenue Canada also 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.

Revenue Canada advised the Tribunal that the subject fabric was dutiable, in 1995, at 16.0 percent *ad valorem* under the MFN tariff and the GPT; at 15.7 percent *ad valorem* under the BPT; at 5.2 percent *ad valorem* under the U.S. tariff; and at 14.0 percent *ad valorem* under the Mexico tariff. Under the recently concluded Multilateral Trade Negotiations, the MFN rate is scheduled to be reduced to 12.0 percent *ad valorem* on January 1, 2004.

Canadian Mill uses the subject fabric to produce resin-coated wiping cloths, commonly referred to as “tack cloth.” The subject fabric is fed through a coating vat where a low molecular weight resin is applied. The coated wiping cloth passes through rollers where the excess liquid is returned to the vat. The wiping cloth is then cut according to the customer’s specifications and packaged for sale. Canadian Mill sells tack cloth to the automobile and furniture industries where it is used to remove dust and dirt particles before the application of paint or a finish. In general, tack cloth can be purchased in hardware stores and painting supply stores.

Most of the imports⁴ of the subject fabric for use in the production of resin-coated wiping cloths originate in the People’s Republic of China and the United States.

REPRESENTATIONS

Canadian Mill alleges that identical or substitutable fabrics are not available from domestic sources. It submits that the removal of the duties on the subject fabric and the subsequent lowering of production costs will allow it to compete with U.S. imports of tack cloth, thereby enabling it to capture a larger share of the Canadian market. Canadian Mill also claims that lower production costs will open up the possibility of effectively competing in the U.S. market. The additional sales would permit Canadian Mill to expand its operations and increase employment.

A letter in support of Canadian Mill’s request was sent on behalf of Smith & Nephew Inc. of Lachine, Quebec. In essence, it fully supports Canadian Mill’s initiative because the subject fabric is not available in Canada and there are no appropriate substitutes available. Texel Inc. of St-Elzéar, Quebec, indicated that it did not oppose the request for tariff relief.

In letters dated February 2 and 9, 1996, Dominion Industrial Fabrics Company (DIFCO) of Montréal, Quebec, indicated that it produces a variety of 100 percent cotton gauze and scrim⁵ fabrics in large volumes, ranging in weight from 65 to 100 g/m², as well as polyester/cotton and polyester scrim fabrics,

4. The total volume and value are considered to be protected information.

5. The Encyclopedia of Textiles, 3rd ed. (Englewood Cliffs: Prentice Hall, 1980) at 581 defines “scrim” as follows: “A durable, plain-weave cotton cloth. Usually made of ply-yarn and low in pick count.”

ranging in weight from 45 to 55 g/m², at its plant in Magog, Quebec. These fabrics are sold to different trades in North America for a large variety of end uses. DIFCO also stated that it does not currently produce and sell fabrics of a weight less than 40 g/m² and that it would be prepared to supply Canadian Mill with a fabric which is very similar to the second sample (weighing about 55 g/m²) submitted to the Tribunal.

While it opposed the request for full tariff relief, DIFCO proposed that the duty-free provision, which exists for unbleached cotton gauze fabric weighing not more than 40 g/m², under classification No. 5208.11.10.10, be extended to bleached fabric. As Canadian Mill's volume appears to be in the 20 g/m² fabric weight, DIFCO submitted that the request would be partially satisfied by an amendment to this provision. In its submission of March 4, 1996, DIFCO reiterated its earlier position to the effect that its proposal would satisfy Canadian Mill's major volume requirements.

In its submission of March 6, 1996, the CTI submitted that the Canadian value added in the production of resin-coated wiping cloths is relatively small and that Canadian Mill's viability does not depend on the outcome of this investigation, since tack cloth sales only represent 3 to 4 percent of its total sales. The CTI also contended that Canadian Mill's projected sales in the U.S. market are questionable, given the current regulatory environment.

The CTI supported DIFCO's proposal and opposed any tariff reduction for the subject fabric weighing more than 40 g/m². It submitted that this would satisfy 75 to 80 percent of Canadian Mill's requirements and that Canadian Mill's evidence supporting its request to extend the range up to 100 g/m² is weak. On the latter point, the CTI objected in principle to the introduction, late in the investigation, of a second sample weighing 56 g/m², as this could prejudice the interest of fabric producers.

The CTI argued that duty drawback provisions regarding goods that qualify for NAFTA tariff treatment have changed and that, by 1998, U.S. suppliers will not be able to obtain any duty drawbacks on their imports of cotton fabrics from the People's Republic of China used in tack cloth exported to Canada. The CTI submitted that rules of origin prevent tack cloth produced in the United States from qualifying as a NAFTA product and that preferential quotas for goods that do not meet the rules of origin do not apply to tack cloth. Furthermore, the CTI stated that Canadian Mill is protected from U.S. imports, since tack cloth made from non-North American inputs are subject to the MFN rate of duty.

Finally, the CTI submitted that Canadian Mill had not shown that tariff removal is required to develop export potential to the United States. In this connection, the CTI stated that, as with U.S. exports to Canada, Canadian exports to the United States would not qualify for NAFTA rates of duty. In addition, changes in the U.S. rules of origin, to be implemented in mid-1996, will have an impact on exports to the United States.

In its response of March 19, 1996, Canadian Mill opposed the proposal put forward by DIFCO and the CTI, stating that the fabric which DIFCO proposed to supply in the 55 to 65 g/m² range is unsuitable (inappropriate weave count and open cut edge). Canadian Mill also pointed out that DIFCO had not responded to its request for pricing information. Canadian Mill indicated that tariff relief would lead to increased volumes of activity and more employment.

On the subject of exports to the United States, Canadian Mill argued that the MFN rate of duty for tack cloth is only 4.6 percent and that this does not constitute an impediment. Canadian Mill stated that the loss of the duty drawback provisions makes it critical for tariff relief to be granted. Furthermore, it is unaware of any future U.S. controls that might impede exports.

Canadian Mill submitted that its original request was for fabric weighing not more than 100 g/m², but, in the spirit of compromise, asked that tariff relief be granted for fabrics up to 65 g/m². In this connection, it argued that DIFCO had not demonstrated a true capability to supply an equivalent and competitively priced fabric.

In a letter dated April 3, 1996, with corrections made on April 9, 1996, DIFCO and the CTI amended their earlier proposal for duty-free imports of cotton gauze, extending the range of the subject fabric to 65 g/m² from 40 g/m², on the condition that the width of the fabric be restricted to less than one metre. Canadian Mill, in a letter dated May 6, 1996, agreed to the amendment proposed by DIFCO and the CTI.

ANALYSIS

The terms of reference direct the Tribunal to assess the economic impact on domestic textile and downstream producers of reducing or removing a tariff and, in doing so, to take into account all relevant economic factors, including the substitutability of domestically produced textiles for imported textiles, the ability of Canadian producers to serve the Canadian downstream industries and domestic versus foreign price competition.

According to Canadian Mill, there is no domestic production of fabrics identical to or substitutable for the subject fabric. This position was partly contested by DIFCO, which argued that it produces, in important volume, a variety of gauze and scrim fabrics weighing from 45 to 100 g/m². DIFCO confirmed that it does not produce and sell fabrics of a weight less than 40 g/m². In this context, DIFCO and the CTI did not oppose the request for tariff relief on fabrics weighing not more than 40 g/m². Moreover, they later proposed, in the event that the Tribunal recommended that tariff relief be granted, that it be extended to fabrics less than one metre in width and weighing not more than 65 g/m².

Therefore, the Tribunal must consider whether the width restriction proposed by DIFCO and the CTI for fabrics weighing not more than 65 g/m² is acceptable to Canadian Mill and whether DIFCO is capable of producing fabrics substitutable for the subject fabric of a weight greater than 65 g/m². On the latter point, the Tribunal believes that DIFCO has shown its expertise in producing similar fabrics and is persuaded that DIFCO has the technical knowledge and capability to produce a fabric that, on balance, meets the requirements of Canadian Mill. In addition, the demand for fabrics in higher weight categories is relatively small at this time. The Tribunal is persuaded that, with increased volumes, the potential for increased efficiencies and economies will exist with respect to prices of domestic fabrics in the longer term. The Tribunal also notes that 75 to 80 percent of Canadian Mill's purchases consist of imported fabric which weighs about 20 g/m². On the matter of limiting the request to the subject fabric less than one metre in width and weighing not more than 65 g/m², the Tribunal notes that Canadian Mill has agreed to the proposal put forward by DIFCO and the CTI. Consequently, the Tribunal believes that granting tariff relief on the subject fabric less than one metre in width and weighing not more than 65 g/m² will satisfy Canadian Mill's major volume requirements.

In the circumstances, the Tribunal concludes that, other than the tariff revenues foregone by the government, there would be no commercial costs of granting tariff relief on the subject fabric weighing not more than 65 g/m². At the same time, the benefit to Canadian Mill would be between \$5,500 and \$24,000 a year in savings on customs duties, based on the historical levels of imports of the subject fabric and the projections made by Canadian Mill. Therefore, the Tribunal believes that granting tariff relief on the subject

fabric weighing not more than 65 g/m² and measuring less than one metre in width will maximize net economic gains for Canada.

With respect to Canadian Mill's ability to export to the U.S. market, the Tribunal has been informed by the Department of Foreign Affairs and International Trade that changes to the U.S. rules of origin, to take effect on July 1, 1996, will require a resin-coated fabric to be marked as a product of the People's Republic of China. As such, finished goods, classified in heading No. 59.07, will not be considered to originate in Canada if manufactured from raw materials classified in heading No. 52.08. Consequently, they will be subject to the control requirements for goods originating in the People's Republic of China. If a permit from the People's Republic of China is required for goods classified in heading No. 59.07, the goods may be precluded from entering the United States.

With regard to Canadian Mill's request for retroactive tariff relief, the Tribunal does not believe that there are extraordinary competitive circumstances warranting such a recommendation.

RECOMMENDATION

In light of the foregoing, the Tribunal hereby recommends to the Minister that the customs duty be removed for an indeterminate period of time solely on importations of bleached, cotton gauze fabrics less than one metre in width and weighing not more than 65g/m², for use in the manufacture of resin-coated wiping cloths.

Arthur B. Trudeau

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