



Canadian International
Trade Tribunal

Tribunal canadien du
commerce extérieur

REPORT TO THE MINISTER OF FINANCE

**REVIEW OF RECOMMENDATION
REGARDING
CERTAIN RING-SPUN YARNS**

NOVEMBER 3, 2003

REVIEW NO. TA-2003-001

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for Louis Shoop
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for Zave Kaufman
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INTRODUCTION

On April 1, 2003, the Canadian International Trade Tribunal (the Tribunal) gave notice¹ that the tariff relief order (Order in Council P.C. 2002-1087) made on June 20, 2002, to implement the Tribunal's recommendation to the Minister of Finance (the Minister) in Review No. TA-2001-001, concerning certain ring-spun yarns (the subject yarns), was scheduled to expire on December 31, 2003. Under the Minister's standing reference, the duty relief provided by this order would cease unless the Tribunal issued a recommendation that tariff relief was still warranted and a tariff relief order was made by the government.

The tariff relief order concerns the following tariff item Nos.: 5205.14.20, 5205.15.20, 5205.24.20, 5205.26.20, 5205.27.20, 5205.28.20, 5205.35.20, 5205.46.20, 5205.47.20, 5205.48.20, 5206.14.10, 5206.15.10, 5206.24.10, 5206.25.10, 5509.53.10, 5509.53.20, 5509.53.30 and 5509.53.40.

On the basis of representations requesting or opposing the initiation of a review received by the Tribunal in reply to the notice, the Tribunal, on May 28, 2003, gave notice² that it would review its recommendation to the Minister of Finance in Review No. TA-2001-001, concerning the subject yarns, as implemented by Order in Council P.C. 2002-1087. This review was conducted pursuant to section 19 of the *Canadian International Trade Tribunal Act*³ and in accordance with the terms of reference received from the Minister on July 14, 1994, as modified,⁴ and the *Textile Reference Guidelines*.

As part of the review, the Tribunal's research staff sent questionnaires to potential producers of yarns identical to or substitutable for the subject yarns. A request for information was also sent to potential users and importers of the subject yarns. Letters were sent to the Department of Foreign Affairs and International Trade (DFAIT) and the Department of Industry (Industry Canada) requesting information that could assist the Tribunal in its review. A Tribunal member and staff visited the premises of Atlantic Fine Yarns Inc. (Atlantic) in Pokemouche, New Brunswick, to view the production process. A report describing this visit forms part of the record.

The Tribunal held a hearing for this review in Ottawa, Ontario, on September 8 and 9, 2003, to obtain further evidence and hear arguments in respect of two specific issues:

- the availability of identical or substitutable ring-spun yarns from domestic producers and their comparability with the subject yarns; and
- the impact on operations (i.e. the effect on sales, prices, profitability and employment) should the tariff relief order be renewed.

The record of this review consisted of all Tribunal exhibits, including the public and protected replies to questionnaires, witness statements and all exhibits filed by the parties throughout the review, as well as the transcript of the hearing. All public exhibits were made available to the parties. Protected exhibits were made available only to counsel who had filed a Declaration and Undertaking with the Tribunal in respect of confidential information.

1. C. Gaz. 2003.I.1033.

2. C. Gaz. 2003.I.1733.

3. R.S.C. 1985 (4th Supp.), c. 47 [*CITT Act*].

4. The terms of reference were last modified on July 4, 2002.

BACKGROUND

Summary of the 1995 Report to the Minister (Request No. TR-94-002)

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 ring-spun, polyester/cotton, blended yarns in specific sizes and compositions,⁵ for use in the production of greige fabrics and, subsequently, children's clothing.

In its report to the Minister, dated July 5, 1995, the Tribunal identified the issues as being, first, whether combed ring-spun yarns were still produced in Canada and, second, whether carded yarns and combed open-end and air-jet yarns were substitutable for the yarns in question. On the first point, the Tribunal concluded that combed ring-spun yarns were no longer produced in Canada. On the second point, the Tribunal believed that carded yarns and combed open-end and air-jet yarns were not substitutable for the yarns in question. In light of the projected positive economic benefits, the Tribunal recommended that tariff relief be granted. In order to provide a degree of stability for Kute-Knit and other users of combed ring-spun polyester/cotton yarns, the Tribunal recommended that the tariff relief be granted for a period of three years.

Summary of the 1996 Report to the Minister (Request No. TR-94-002A)

The Tribunal's recommendation in Request No. TR-94-002 was not implemented, and as a result of further representations from interested parties, the Minister requested, on November 22, 1995, pursuant to section 19 of the *CITT Act*, that the Tribunal inquire into information that was submitted to him by Canadian Yarns Ltd., a producer of certain carded open-end yarns, taking into account information previously submitted to the Tribunal in connection with its investigation in Request No. TR-94-002, together with any other information that the Tribunal considered appropriate in the circumstances. The reference also directed the Tribunal to report, within 60 days from the date of reference, as to whether tariff relief was warranted on the combed ring-spun polyester/cotton yarns in question.

On January 22, 1996, on the basis of its examination of all the information and submissions in Request No. TR-94-002A and its re-examination of the record in Request No. TR-94-002, the Tribunal reported to the Minister that it found no reason to change the recommendation in Request No. TR-94-002 and, hence, that it re-affirmed its recommendation that the customs duty on importations of combed ring-spun polyester/cotton yarns be removed for a three-year period.

After extensive consultations with yarn spinners and textile knitters, the Minister decided,⁶ in lieu of adopting the Tribunal's recommendation in Request No. TR-94-002A, to recommend to the Governor in Council that the tariff be removed for three years on the following inputs:

- certain combed or carded ring-spun cotton and polyester/cotton yarns, measuring 190 decitex or less (31s and finer) for use in the manufacture of knitted fabrics or knitted garments;
- certain combed or carded ring-spun cotton two-ply yarns, measuring less than 125 decitex per single yarn (finer than 47s), for use in the manufacture of knitted fabrics or knitted garments; and

5. Namely, 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), *Re Request for Tariff Relief by Kute-Knit Mfg. Inc.* (5 July 1995), TR-94-002 (CITT) at 1. Yarn sizes are in the English cotton yarn numbering system.

6. The Minister provided this information to the Tribunal by letter dated July 24, 1996.

- certain combed ring-spun polyester/cotton yarns, measuring 492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s), for use in the manufacture of children's knitted wear.

On July 10, 1996, as a result of the Minister's recommendation, the Governor in Council approved tariff reductions for the yarns that are outlined above through the adoption of the *Customs Duties Reduction or Removal Order, 1988, amendment* and the *Knitting Yarns Remission Order, 1996*. The *Customs Duties Reduction or Removal Order, 1988, amendment* introduced Codes 4117 and 4118, which eliminated the tariff on these yarns for use in the manufacture of knitted fabrics or garments; the *Knitting Yarns Remission Order, 1996* provided for the remittance of duty on certain blends of combed ring-spun polyester/cotton yarns for use in the manufacture of children's knitted wear. In addition, the Minister informed the Tribunal that he had removed from the textile reference, for three years, cotton and polyester/cotton knitting yarns measuring more than 190 decitex (coarser than 31s).

Summary of the 1999 Report to the Minister (Review No. TA-98-004)

In 1999, the Tribunal conducted a review of the 1996 recommendation to the Minister. In its report to the Minister, dated June 18, 1999, the Tribunal indicated that there existed a broad consensus in the spinning and knitting industries that, as a minimum, the tariff relief on certain ring-spun yarns, as was implemented at the time, should be continued for an additional period of three years.

The Tribunal noted that, as a result of the July 1996 compromise between spinners and knitters that led to the adoption of the *Customs Duties Reduction or Removal Order, 1988, amendment* and the *Knitting Yarns Remission Order, 1996*, the scope of the tariff relief that was provided on ring-spun yarns was significantly different from both the tariff relief that was originally sought by Kute-Knit and that which was contemplated in the Tribunal's 1995 recommendation.

The Tribunal indicated that the tariff relief that it recommended and the result of the 1996 compromise were so closely linked that any attempt to dissociate them would have been impracticable, if not impossible, especially in light of the broad consensus that existed in the industries which were affected by the measures in place. On the other hand, the Tribunal noted that parties wishing to obtain tariff relief on yarns which were not encompassed by the two orders of July 10, 1996, still had the option of filing a properly documented request with the Tribunal, provided the yarns fell within the Tribunal's terms of reference.

In addition, notwithstanding that some parties suggested that tariff relief be continued on an indeterminate basis, the Tribunal was of the view that the industries' consensus was possible only if the application of its recommendation were limited to a fixed period.

With regard to the question of whether certain knitting yarns could continue to be excluded from the purview of the textile reference, the Tribunal was of the view that this issue rested entirely within the Minister's authority and that the Tribunal could not, in any recommendation, specify which textile inputs should or should not be included in the reference.

The Tribunal also noted that, from an economic point of view, tariff relief had provided domestic users of the subject yarns with benefits that were worth millions of dollars each year. Furthermore, the Tribunal stated that it did not receive any evidence that the factors that led it to recommend that tariff relief be granted had significantly changed since it issued its recommendation, or that there would be any costs, other than forgone federal revenues, in recommending that tariff relief be extended for a further three-year period.

In light of the foregoing, the Tribunal recommended to the Minister that tariff relief, as provided by tariff item Nos. 5205.14.20, 5205.15.20, 5205.24.20, 5205.26.20, 5205.27.20, 5205.28.20, 5206.14.10, 5206.15.10, 5206.24.10, 5206.25.10, 5509.53.10, 5205.35.20, 5205.46.20, 5205.47.20 and 5205.48.20, and the remission of duties provided by the *Knitting Yarns Remission Order, 1996*, be continued beyond June 30, 1999, for an additional period of three years.

On July 28, 1999, the government implemented the Tribunal's recommendation, but replaced the *Knitting Yarns Remission Order, 1996* with three new tariff items: 5509.53.20, 5509.53.30 and 5509.53.40.

Summary of the 2002 Report to the Minister (Review No. TA-2001-001)

In 2002, the Tribunal conducted a review of the 1999 recommendation to the Minister. The Tribunal held a public hearing on March 6 and 7, 2002, to obtain further evidence and hear arguments in respect of three specific issues. These were:

- the availability of identical or substitutable ring-spun yarns from domestic producers and their comparability with the subject yarns;
- the substitutability of carded ring-spun yarns for combed ring-spun yarns; and
- the impact on operations (i.e. effect on sales, prices, profitability, employment), should the tariff relief order be renewed.

In essence, the knitting industry supported the continuation of the tariff relief, submitting that such relief has enabled it to maintain its production base in Canada and has enabled knitters and their customers to remain competitive in the face of increasing imports of finished garments. On the other hand, Atlantic, which commenced operations on October 15, 2001, submitted that the tariff relief order should be allowed to expire as scheduled, since it has the ability and the production capacity to produce identical or substitutable yarns.

With respect to the availability of identical or substitutable *carded* ring-spun yarns measuring 190 decitex or less (31s and finer), the Tribunal noted that Atlantic produced and sold non-subject carded yarns in the coarser counts (below 31s). Based on information contained in a price list dated January 10, 2002, the Tribunal determined that Atlantic was not yet in a position to provide carded ring-spun yarns in the finer counts of 32/1⁷ and above. Furthermore, Atlantic indicated that the carded ring-spun yarns that it sold in Canada had an average count of 24/1.⁸ As far as the availability of identical or substitutable *combed* ring-spun yarns was concerned, the Tribunal noted that, based on the evidence, Atlantic was not in a position to supply such yarns, including those in the coarser range, i.e. 12s, 18s, 24s, required for use in the manufacture of children's knitted wear.

Turning to the question of substitutability, the Tribunal was not convinced that carded ring-spun yarns were substitutable for combed ring-spun yarns.

The Tribunal concluded that Atlantic was not, as yet, able to respond to the specific requirements of the knitting industry for the subject yarns covered by the tariff relief order.

In terms of impact on their operations, importers and users of the subject yarns argued that, should duties be re-imposed, their operations would be adversely affected, since they would not be able to pass on

7. This designates 32s, single yarn.

8. This designates 24s, single yarn.

this extra expense to their customers in a competitive environment where “the price is the biggest issue . . . [and] [p]rice is king”.

Much of Atlantic’s case was based on the premise that it would soon have identical or substitutable yarns available to the marketplace in adequate commercial quantities and at competitive prices, and that its plant would be operating at near capacity, thereby lowering its unit production costs and prices. As the foregoing was based on speculation, the Tribunal was unable, at that time, to conclude that Atlantic would be in a position to produce and supply identical or substitutable yarns, in commercial quantities and at competitive prices.

On the basis of the information available, the Tribunal believed that tariff relief would continue to provide a degree of stability for users of the subject yarns and benefits in the form of reduced costs, thereby enabling them to maintain their competitive position in a very price-sensitive marketplace.

The Tribunal noted that some factors that led it to recommend, in June 1999, that tariff relief be granted for a further three-year period had changed, notably the commencement of Atlantic’s operations in October 2001 as a producer of ring-spun yarns. Atlantic had invested considerably in its Phase 1 facility at Pokemouche, and planned to enhance its production capabilities with combing machinery in the very near future.

Recognizing that Atlantic had provided sufficient evidence that it might have the capability to produce identical or substitutable yarns in the not too distant future, the Tribunal recommended to the Minister that tariff relief be continued beyond June 30, 2002, for an additional 18-month period. In the Tribunal’s view, this would provide Atlantic with sufficient time to vigorously pursue the subject yarns business and demonstrate to potential users that it could provide yarns at a competitive price that would meet their requirements.

On June 20, 2002, the government implemented the Tribunal’s recommendation.

PRODUCT INFORMATION

The tariff relief covers certain carded or combed ring-spun cotton and polyester/cotton yarns of 190 decitex or less for use in the manufacture of knitted fabrics and garments and combed ring-spun polyester/cotton yarns of specified cotton counts for use in the manufacture of children’s knitted garments.

Yarn is defined as a continuous strand of textile fibres that may be composed of endless filaments or shorter fibres twisted or otherwise held together. There are, at present, different systems in use to measure the fineness of yarn. The tex system is a method of numbering yarns, fibres and all types of textile strands. It is part of the International System of Units and is intended to gradually replace the diverse numbering systems now used for cotton, woollen and worsted yarns, and the denier system. The tex number of a yarn is the weight in grams of one kilometre of material. The decitex (0.1 tex) is a variation of the basic tex unit. Under this system, the lower the number, the finer the yarn. The cotton yarn system, which is used almost exclusively in the United States and the British Commonwealth, is based on the number of 840-yard lengths per pound. Thus, 1s have 840 yards per pound, 2s have 1,640 yards per pound, 10s have 8,400 yards per pound, and so forth. In the British Commonwealth, this system is referred to as the “English cotton yarn numbering system” and is designated “Ne”.⁹ Under this system, the higher the number, the finer the yarn. It

9. Industry practice is to produce yarns in even Ne counts (e.g. 24, 28, 32).

is noted that there is an inverse relationship between decitex and cotton count. As the decitex decreases (yarn becomes finer), the cotton count increases.¹⁰ The following table illustrates this point.

	Ne	Decitex
Coarse	12	492
↓	18	328
↓	24	246
↓	31	190
↓	36	164
↓	48	124
↓	56	106
Fine		

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 matter 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. 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. Twist is inserted into a yarn after it emerges from the front drafting rolls by passing it through a yarn guide, to a traveller and to a rapidly rotating bobbin, simultaneously and continuously.

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

As of January 1, 2003, the subject yarns classified under tariff item Nos. 5205.14.20, 5205.15.20, 5205.24.20, 5205.26.20, 5205.27.20, 5205.28.20, 5205.35.20, 5205.46.20, 5205.47.20, 5205.48.20, 5206.14.10, 5206.15.10, 5206.24.10, 5206.25.10 and 5509.53.10 are duty free under the MFN Tariff, the United States Tariff, the Least Developed Country Tariff, the General Preferential Tariff, the Mexico Tariff, the Canada-Israel Agreement Tariff, the Chile Tariff and the Costa Rica Tariff. The subject yarns classified under tariff item Nos. 5509.53.20, 5509.53.30 and 5509.53.40 are duty-free under the MFN Tariff, the United States Tariff, the Least Developed Country Tariff, the Mexico Tariff, the Canada-Israel Agreement Tariff, the Chile Tariff and the Costa Rica Tariff.

10. *Dictionary of Fiber & Textile Technology*, 3d ed. (Charlotte, NC: Hoechst Celanese, 1990); *Fairchild's Dictionary of Textiles*, 7th ed. (New York: Fairchild's, 1996).

WRITTEN REPRESENTATIONS OF THE PARTIES IN FAVOUR OF THE CONTINUATION OF THE TARIFF RELIEF

Knitters and Yarn Suppliers¹¹

Knitters and yarn suppliers (the knitting industry) submitted that the duty-free treatment accorded to the subject yarns should be continued indefinitely because Atlantic has not met the criteria or tests established by the Tribunal in its recommendation of May 2002. They also indicated that the continuation of tariff relief on the subject yarns is critical to the continued existence of a viable knitting, dyeing and garment industry in Canada.

The knitting industry stated that ring-spun cotton yarns in sizes finer than 31s are not available from Atlantic, except in 32s. It also claimed that Atlantic had not demonstrated, either by price quotations or other means, that it was able to provide yarns at a competitive price that would meet the knitting industry's requirements in competition with leading offshore suppliers. The knitting industry indicated that, in addition to the physical characteristics that distinguished the subject yarns from domestic yarns, the subject yarns are cheaper and are readily available in a wide range of products and this plays a role in its preference for the subject yarns.

Kute-Knit indicated that, since the tariff relief order, Atlantic has only been producing 100 percent cotton combed ring-spun yarns and, to date, does not produce blended polyester/cotton yarns of 492 decitex (12s), 328 decitex (18s) and 246 decitex (24s). Therefore, Kute-Knit submitted, these yarns should remain duty-free, and the end use should not be limited to the manufacture of children's wear. Domestic Converters Inc. also stated that duty-free treatment should be applied to a broader range of yarns.

The knitting industry indicated that the subject yarns are different from yarns that may be available from domestic sources because they are made from a longer staple that requires less twist, making them easier to dye and knit. The knitting industry stated that fabrics produced with the subject yarns have a very soft hand, are smoother and brighter in appearance, and are more comfortable to wear than fabrics manufactured with domestic yarns. On the other hand, domestic and U.S. yarns, which typically use U.S. raw cotton, have a higher twist due to a shorter fibre length and a much rougher "hand". The knitting industry submitted that garments manufactured with imported yarns are superior to similar garments produced with inferior domestic yarns.

The knitting industry submitted that the business environment of ring-spun yarn users in Canada has been damaged unexpectedly by the implementation of the Least Developed Country (LDC) initiative on

11. The positions of knitters and yarn suppliers were summarized using the responses to the Tribunal's questionnaire that were submitted by Agmont Inc., Beau-Fab Inc., Cannon Knitting Mills Ltd., Château Lingerie Manufacturing Inc., CVT Knitting Mills Inc., Desa Imports (supplier), Les Vêtements Prestigio Inc., North East Knitting Mills Inc., Promptex Yarns Inc. (supplier), Roopa Sales and Trading Ltd., Stanfield's Limited, Tobelle Textiles Inc., Underwear Mills Inc. and Worldbest Canada Inc. Responses to the Tribunal's questionnaire and submissions made by Domestic Converters Inc. (supplier), Kute-Knit, Laxer Fibre Co. Ltd. (supplier), Main Knitting Inc., Manoir Inc., The Nalpac Company, St. Lawrence Textiles Inc. and Tricots Liesse Inc. were also included.

January 1, 2003.¹² The knitting industry stated that there is unlimited capacity in the LDCs to produce knitted apparel with fabrics or yarns imported into these countries. Moreover, the knitting industry submitted that, should the Tribunal decide to re-impose duties on the subject yarns, the Tribunal would be creating a tariff anomaly. The knitting industry submitted that it and its domestic customers face severe competition, particularly from Asia. It submitted that, by virtue of the final phase of the World Trade Organization (WTO) regime for the elimination of garment quotas, which is due to take effect on January 1, 2005, garment suppliers with manufacturing facilities in the People's Republic of China (China) will enjoy unfettered access to the Canadian market.

The knitting industry submitted that it was experiencing serious difficulties at the time of the most recent review, because demand for its products was weak in Canada and the U.S. Caribbean Basin legislation¹³ was inhibiting its exports to the United States. It stated that the situation is no better in 2003, because domestic demand remains weak and the Canadian export potential is undermined by increases in the manufacture, in the Caribbean and Andean countries, of apparel from U.S. fabric, which is re-imported duty free in the form of apparel for consumption in the U.S. market. The knitting industry indicated that, as a result of the competition from developing countries, as well as increasing market protectionism in the United States, it must offer products at competitive prices to maintain its market share. It added that a key factor in this regard is the continuation of the tariff relief on the subject yarns. The knitting industry also stated that there have been a significant number of recent business failures in the apparel industry. It indicated that the existing customer base is also being weakened by recent exchange rate trends. The knitting industry submitted that, overall, the international context represents a significant threat to the well-being of Canadian manufacturers. This puts into question the viability of the Canadian knitting and garment manufacturing industries.

The knitting industry stated that Canadian apparel manufacturers are under constant pressure to lower prices in order to maintain market share. In this regard, it indicated that the country's largest retailers, such as Wal-Mart and Zellers, and smaller chain stores resist price increases and that yarn users are unable to absorb cost increases in the face of falling landed prices of imported fabrics and garments.

The knitting industry stated that yarns eligible under the *North American Free Trade Agreement*¹⁴ (*NAFTA* yarns)¹⁵ usually command a substantial premium over non-*NAFTA* yarns. The knitting industry

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12. Since January 1, 2003, textile and apparel products exported to Canada from LDCs are eligible for duty free treatment provided that they have been manufactured or produced with inputs from any of the 48 eligible LDCs, of which 34 are located in Africa, or have been produced with inputs from General Preferential Tariff beneficiary countries (e.g. China), provided the value-added in the LDC exporting country is at least 25 percent. This initiative also removes existing quotas on textile and apparel products that qualify for tariff elimination under the new rules.
 13. Almost all Caribbean Basin countries have been beneficiaries since 1984 of the *Caribbean Basin Initiative (CBI)*, a unilateral U.S. trade preference program that provides free access to the U.S. market for most Caribbean Basin exports. In May 2000, the United States enacted a further enhancement of the *CBI* through the *Caribbean Basin Trade Partnership Act (CBTPA)*, which reduces or eliminates U.S. duties on those products not previously covered by the *CBI*. The new legislation was implemented on October 2, 2000. The main benefit of the *CBTPA* is the duty-free and quota-free entry for apparel assembled in *CBI* countries from U.S. fabrics made with U.S. yarns and cut in the United States. If the U.S. fabrics used in the production of such apparel are cut into parts in *CBI* countries rather than the United States, the apparel must also be sewn together with U.S. thread. Duty and quota-free treatment is also available for certain knit apparel made in *CBI* beneficiary countries from fabrics produced in the Caribbean Basin region, provided that U.S. yarns are used in producing the fabric.
 14. 32 I.L.M. 289 (entered into force 1 January 1994) [*NAFTA*].
 15. To qualify for duty-free access under *NAFTA*, textile and apparel products must be produced with yarns made in a *NAFTA* country from *NAFTA* fibres.

indicated that, when customers require fabric to be made with *NAFTA* yarns, knitters buy domestic yarns to the extent that they are available. Where the specified yarns are not available from domestic producers, they must buy U.S. or Mexican yarns. In cases where the yarn count is finer than 31s and the customer does not specify *NAFTA* yarns, the knitting industry indicated that it purchases offshore yarns at prices that would be highly competitive with or without the MFN duty. Thus, the knitting industry submitted, there appears to be no point in re-imposing duties on the subject yarns.

The knitting industry submitted that, should duties be re-imposed on the subject yarns, its viability would be adversely affected. This could drive up the cost of yarn and lead to an increase in the selling prices for Canadian-made fabrics and garments. As a result, the manufacture of products made with the subject yarns would decrease significantly and sales would be adversely affected; this, in turn, would lead to a decrease in labour requirements and negative financial performance, and would limit the ability to invest in research and development and in plant modernization. Finally, the knitting industry indicated that it does not believe that the re-imposition of duties would enhance either Atlantic's sales or its profitability.

Cavalier Textiles (Cavalier)

Cavalier, of Saint-Laurent, Quebec, is a spinner of specialized spun yarn and strand yarn. Cavalier did not oppose the continuation of the tariff relief order as long as the current provisions remain intact and are not subject to any expansion. Cavalier stated that, if the tariff relief were to be expanded to cover coarser yarns measuring more than 190 decitex, this would ultimately lead to further erosion of its sales.

Cavalier also indicated that the existing duty-free provisions were implemented by the Department of Finance as part of a package of measures that incorporate the following two key elements: (1) duty-free entry for certain fine-count ring-spun yarns for knitted fabrics and garments; and (2) the exemption from the textile reference of other types of cotton and polyester/cotton knitting yarns. Cavalier requested that the second element of the original package be continued, should tariff relief be extended.

Minister of Regional Economic Development, Province of Quebec (Quebec)

Quebec declared that many companies in the province submitted arguments in favour of continuing the tariff relief. It emphasized that the knitted fabrics and knitted garments industry accounts for 16,000 manufacturing jobs in Quebec.

Quebec submitted that the arguments of the companies in favour of continuing the tariff relief can basically be summarized by the following two statements : (1) the domestic production of fine yarn does not allow them to maintain their competitive advantage with regard to availability of supply, quality or cost; and (2) without the continuation of tariff relief, their production costs would increase to such a level that their products would become prohibitively expensive for their own clients.

Quebec stated that, in the national economic setting as well as the international one, it is in the best interest of Quebec's textile industry that tariff relief be again continued for an indefinite period of time.

WRITTEN REPRESENTATIONS OF THE PARTIES OPPOSED TO THE CONTINUATION OF THE TARIFF RELIEF

Atlantic

Atlantic, of Mississauga, Ontario, was founded in 2000 to produce ring-spun yarns in Pokemouche. It currently employs 203 persons. Atlantic indicated that the end use of its production in Pokemouche is for the weaving and knitting of fabrics for use in household textiles, apparel and leisure wear.

Atlantic stated that its ring spinning facility is to be completed in four phases. Phase 1 production commenced on October 15, 2001. According to Atlantic, the machinery in Phase 1 is capable of producing 14 million kilograms per year of 100 percent cotton and polyester/cotton ring-spun yarns with counts ranging from 130s to 6s. Atlantic stated that the approximate costs of plant, machinery and equipment under Phase 1 were \$70 million. Atlantic indicated that Phase 2 was originally to be completed in 2002 at an additional cost of \$80 million, subject to the viability of Phase 1. Phase 2 would add a further 150 employees and provide an extra 14 million kilograms of production capacity per year of 100 percent cotton and polyester/cotton ring-spun yarns with counts ranging from 130s to 6s. However, Atlantic stated that Phase 2 had not been started, in part due to the continued lower price competition facing its production as a result of the existing tariff relief.

Atlantic stated that, if sales developed under Phase 2 as anticipated, Phases 3 and 4 would be completed, subject to the availability of labour, energy and capital. Atlantic indicated that the product mix of each of the mills would reflect market demand. In September 2002, to meet any Canadian market requirements for combed ring-spun yarns, Atlantic installed combing machinery for up to one third of its production capacity at a cost of over \$3 million and started production of 100 percent cotton combed yarns in October 2002.

Atlantic submitted that the existing tariff relief should be allowed to expire as scheduled. Atlantic stated that Canadian production could, even with Phase 1 only, fulfil all or almost all domestic demand for identical or substitutable yarns. Atlantic submitted that the range of ring-spun yarns that it can produce is identical to or substitutable for the subject yarns. Although Atlantic does not produce two-ply yarn, it stated that it produces single-ply yarn, which can readily be twisted into two-ply yarn by other Canadian companies.

Atlantic stated that its yarns are produced to international specifications and quality standards, by similar process, with similar fibres of similar construction, yarn sizes and yarn types for each end use and are identical to and completely substitutable for the subject yarns. Atlantic indicated that its yarns offer some distinct advantages and superior specifications, including the use of high-quality select grade U.S. cotton with complete bale data. Moreover, through the use of sophisticated bale management software, Atlantic's yarns are produced with a consistent lot number throughout a crop year, which is a significant advantage over imported yarns that have a different lot number for each container. Atlantic also stated that its yarns are steamed for low torque and better feel. Atlantic submitted that, unlike many of the ring-spun yarns from India and Pakistan, its ring-spun yarn is free of contamination, which helps produce defect-free bleached and light coloured fabrics. In most, if not all, markets, contamination-free yarn commands a premium compared to the normal cotton yarns from countries with a problem of contaminated yarn.

Atlantic indicated that the acceptability of its product is evident from the fact that many of the knitters participating in this proceeding have purchased ring-spun yarn from Atlantic. Atlantic indicated that it conducted quality comparisons at its testing facilities, comparing Atlantic and imported carded 20s, combed 26s and combed 32s. Yarn characteristics such as uniformity, imperfections, tenacity, elongation and hairiness were tested. Based on these criteria, Atlantic submitted that the quality of its yarns was either superior to the subject yarns or within acceptable tolerances of industry standards.

Atlantic submitted that the distinction between the subject yarns (31s and finer) and non-subject yarns (below 31s) is completely arbitrary and is of no real value in establishing differences in usage. According to Atlantic, duty-free status for cotton 32s has encouraged its importation instead of the importation of 30s, for example. Atlantic indicated that domestically produced cotton yarns below 31s do compete with imports and, in fact, are projected to gain increasing market share.

Atlantic indicated that it would currently be producing significantly finer yarn but for the tariff concession. Atlantic added that, from the perspective of capacity utilization and gross margins, it requires significant production and sales of the finer yarns identical to or substitutable for the subject yarns and cannot remain viable by selling only coarser counts of yarn in the Canadian market. Atlantic submitted that its sales of combed and carded finer ring-spun yarns have been increasing in Canada since the Tribunal's previous review.

Atlantic submitted that Canadian knitters regularly substitute domestically produced ring-spun yarns for offshore yarns for the same end products for reasons such as: (a) the need for contamination-free yarns for whites and pastel colours; (b) quick deliveries; and (c) *NAFTA* content requirements.

With respect to pricing, Atlantic stated that there are a variety of factors that may or may not appear in the stated price of an imported product. For example, there may be issues, such as having to use and pay for letters of credit or having to pay in advance for imported yarns, which have the effect of raising the cost of an imported product. Furthermore, the terms of trade for the sale of yarns vary widely. All these costs are not reflected in invoice prices from offshore suppliers and, for this reason, comparisons of Atlantic's prices with those of offshore yarns are deceptive.

Atlantic indicated that removing the tariff concession would have little impact on the majority of the knitters that are currently buying from brokers, if they were to purchase their yarns from Atlantic. It submitted that its prices would be comparable to the prices charged by brokers. Atlantic submitted that tariff relief benefits only the brokers and the large knitters that buy directly from overseas yarn producers. Atlantic submitted that it has been fully price competitive to large and small customers in respect of the non-subject ring-spun yarns and that, should the tariff concession be removed, it would be equally competitive in the market for the subject yarns.

Atlantic indicated that, taking into account the benefits associated with purchasing from a domestic producer (delivery, security of supply, consistency of quality), Atlantic is completely competitive with the subject yarns. Moreover, Atlantic submitted, its presence has in fact kept the price of ring-spun yarn low in Canada for knitters. It indicated that, internationally, the price of ring-spun yarn has risen by about 10 percent due to the increase in raw cotton prices. In Canada, pricing has been static or has declined.

Atlantic submitted that, even if yarn prices were to increase by the full amount of the duty, the overall impact on fabric costs would actually be closer to one half of that increase, with an impact on the costs of garments made with such fabric of one half of that amount again, i.e. less than 2 percent. Atlantic also submitted that, should the tariff concession be removed, Atlantic's ring-spun yarn pricing would not increase by the full amount of the duty.

Atlantic indicated that, should tariff relief on the subject yarns be extended, jobs and an overall investment of \$150 million under Phases 1 and 2 would be jeopardized, as well as jobs and further investments projected in Phases 3 and 4.

Minister of Business, Province of New Brunswick (New Brunswick)

New Brunswick submitted that the tariff relief on the subject yarns should not be extended beyond December 31, 2003. It argued that reinstating the duties on the subject yarns would afford Canadian ring-spun yarn manufacturers the opportunity to become economically viable and competitive within Canada. It indicated that reinstating the duties would also assist in the development of this sensitive sector within New Brunswick and in Canada.

New Brunswick submitted that circumstances have changed significantly since the last review, because Atlantic has indicated that it can produce identical or substitutable yarns and that it can serve the needs of the Canadian downstream industries.

New Brunswick submitted that Atlantic represents a cornerstone operation in the efforts of successive New Brunswick governments to diversify the economy of the northeast region of New Brunswick. It also submitted that, with its primarily resource-based economy, the Acadian Peninsula has been negatively impacted by the collapse of the Atlantic fishery and suffers from the highest unemployment rates in the province.

New Brunswick submitted that Atlantic's current Phase 1 has already had a positive impact on the economy of the region with the creation of 150 direct jobs. It also submitted that the economic spinoffs of Atlantic's project have resulted in the creation of indirect jobs and have increased buying power in the region.

REPLY SUBMISSION

Main Knitting Inc. (Main)

Main submitted that Atlantic is not in a position to supply the domestic market with ring-spun yarns in the finer counts. It stated that the level of production planned by Atlantic for combed 32s would not meet Main's demand, even if the duties were re-imposed. Main submitted that Atlantic's planned production for carded 32s would not meet the needs of the total Canadian market. Main indicated that the re-imposition of duties would only serve to increase yarn input costs. Main also submitted that the establishment of Atlantic in the Pokemouche region and the ensuing benefits were based upon its ability to be price competitive for non-subject yarns.

OTHER INFORMATION

Quantitative Import Restrictions

DFAIT informed the Tribunal that Canada currently maintains a quota restraint on polyester/cotton blended yarn (category 24.0), imported from the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu. Accordingly, this coverage includes the subject yarns of subheading No. 5509.53.

Canada does not maintain quota restraints on the other yarns classified in heading Nos. 52.05 and 52.06. These yarns, therefore, are not subject to any quantitative import restrictions.

In addition, DFAIT also indicated that it would consider requests for ex-quota entry on textile inputs where a recommendation has been made by the Tribunal to remove customs duties on the basis of non-availability of domestic supply. Ex-quota treatment will only be granted in cases where it can be demonstrated that there is an extra charge for using products under quota or where goods are not otherwise available in Canada.

ORAL ARGUMENTS

Knitting Industry¹⁶

The knitting industry argued that Atlantic's decision not to oppose the continuation of tariff relief for ring-spun yarns finer than 32s was made because these yarns are not available from Atlantic.¹⁷ The knitting industry argued that, if there is sufficient economic incentive to do so, there might be some substitutability between domestic and imported 32s. However, in terms of properties, Atlantic's 32s are not identical to or substitutable for the imported 32s. The knitting industry submitted that, when comparing yarn made in India from long staple cotton with a spinning limit of 60s with Atlantic's yarn that uses U.S. cotton with a much lower spinning limit, shorter fibre length and thicker diameter, it comes as no surprise that the Indian yarn, at any given level of twist, is going to appear to some as softer and more desirable.

The knitting industry argued that, should tariff relief be continued on the 32s, the impact on Atlantic would be minimal. After excluding the component requiring *NAFTA* yarns from the total market for 32s, the knitting industry submitted, Atlantic could lose potential sales of \$3 million or a potential contribution of \$1 million. However, the knitting industry argued that the Tribunal should not take this into consideration because, in a capital-intensive plant, it is imperative to maximize capacity utilization. According to the knitting industry, if potential production is lost, other options, including new opportunities in the market requiring *NAFTA* yarns, could be pursued, which, in certain situations, could be equally profitable.

The knitting industry argued that the higher consumption in Canada of 32s relative to 30s as compared to the consumption in the United States is probably due to the removal of the Canadian tariff on 32s nine years ago, as the knitters took advantage of this opportunity and built their businesses on the basis of that economic advantage.

The knitting industry argued that the LDC initiative has led to increasing price pressure from major retailers. The knitting industry also argued that currency imbalances have adversely affected operations. In this regard, it submitted that China's currency is substantially undervalued, which partially explains the rapid increase in imports of finished goods from that country. The knitting industry argued that these events have increased competition and weakened its current customer base. The knitting industry submitted that Atlantic should also be concerned about the survival of knitters because there cannot be sales to customers that have been destroyed by bankruptcy or have moved out of the country.

Finally, the knitting industry argued that, according to its calculations, Atlantic's production of 32s involves approximately 42 jobs, whereas the knitting and apparel industries employ a far greater number of workers.

Main

Main argued that tariff relief on the subject yarns should be allowed to continue for at least three years. Main submitted that, based on the evidence, Atlantic is not in a position of imminent production, as demonstrated by orders on hand and actual sales regarding identical or substitutable products, and that it cannot meet even Main's demands in respect of ring-spun combed yarns.

16. Domestic Converters Inc., Laxer Fibre Co. Ltd., Manoir Inc., The Nalpac Company, St. Lawrence Textiles Inc. and Tricots Liesse Inc.

17. Up to the time of the hearing, Atlantic was opposed to the continuation of tariff relief. However, on the second day of the hearing, Atlantic amended its earlier position and requested that the existing tariff concession be allowed to continue, except on combed or carded ring-spun *cotton* 31s and 32s. *Transcript of Public Hearing*, 9 September 2003 at 251-52.

Main argued that, based on its existing commercial needs with respect to combed and carded 32s, Atlantic cannot offer adequate commercial quantities at competitive prices. Main argued that, should duties be re-imposed on the subject yarns, Atlantic's prices would still not be competitive. Main argued that, if tariff relief were terminated, it would not buy one extra kilogram of 32s from Atlantic.

Main argued that Atlantic's decision not to oppose the continuation of tariff relief on yarns finer than 32s came only because it does not produce finer counts. Main argued that, in any event, it could easily move to 33s, if necessary. Main argued that, should tariff relief be terminated, it would lose approximately \$2 million in revenues yearly and would seriously consider moving additional production offshore, which would represent 75 percent of its total production capacity being located outside Canada. Main submitted that this would lead to a loss of 1,700 workers or \$34 million to the economy in Quebec.

Kute-Knit

Kute-Knit argued for the continuation of tariff relief on the subject yarns for an indeterminate period or, in the alternative, for a period of not less than three years.

Kute-Knit argued that, based on the evidence, Atlantic cannot supply ring-spun yarns, combed 32s in particular, at competitive prices and in quantities sufficient to meet the domestic demand. Kute-Knit argued that Atlantic's own customer base should not be forced to absorb a possible price increase at the expense of making Atlantic's financial position more tenable. Kute-Knit argued that, in the medium and longer terms, both parties would suffer the consequences of the re-imposition of duties.

Kute-Knit argued that Atlantic should focus more on supplying *NAFTA*-products to Canadian apparel manufacturers that export their products to the United States. It submitted that this category of producers would comprise the vast majority of Canadian apparel manufacturers. Kute-Knit argued that the LDC initiative and the imminent removal of quotas on January 1, 2005, pose a serious threat to the whole industry.

Quebec

Quebec argued that the consequences of imposing duties on the yarns in question are numerous. Quebec submitted that the province's textile industry accounts for 16,000 jobs, representing 53 percent of the domestic industry. Should duties be again imposed, Quebec argued, between 2,000 and 4,000 jobs, with an average salary of \$28,000 per job, would be lost in the province.

Quebec also said that world-wide competition has recently increased as a result of the implementation of various measures and international agreements, and that this competition would continue over the next few years. Quebec argued that this additional pressure causes constriction in an already difficult economic setting. Quebec indicated that the numerous corporate bankruptcies occurring in recent years are proof of this, as they are symptomatic of what is going on at the moment.

Quebec alleged that Atlantic did not demonstrate that it is in fact possible to obtain yarns that are identical or substitutable to the yarns in question and did not guarantee that it would be so in the future. Additionally, Quebec argued that the imposition of duties is not a cure-all and does not solve all of Atlantic's problems, as many other factors are at play.

Lastly, Quebec submitted that the Tribunal has a mandate to study the effects on downstream companies as well as companies requesting the re-imposition of duties. On this subject, Quebec indicated

that the imposition of duties on the yarns in question could result in the loss of a few thousand jobs rather than a few hundred if, in the end, Atlantic should cease operating.

Atlantic

Atlantic submitted that, in the last review, the Tribunal recommended that the tariff relief be extended for only 18 months instead of three years, to give Atlantic time, “to vigorously pursue the subject yarn business and demonstrate to potential users that it could provide yarns at a competitive price”. Atlantic argued that it has met these conditions and that, by investing in and installing the most modern combing equipment at its facility, it has managed to produce and start selling combed ring-spun yarns in volume.

Atlantic argued that, since it does not dispute the extension of tariff relief on polyester/cotton yarns and on 33s and finer, this reduces the potential impact zone of any decision on the tariff concession. Atlantic submitted that the potential size of the Canadian ring-spun yarn market for 32s is 6 million kilograms and that, if the tariff concession is not extended, this would represent annual duties of between \$1.5 and \$2 million.

Atlantic also argued that it has the capacity to supply the entire yarn requirements of Canadian purchasers. Atlantic argued that its ability to produce up to 33s is clear from all the evidence. Moreover, Atlantic argued that, based on quantifiable objective standards recognized internationally and required yarn quality criteria, its yarns compare favourably with the subject yarns. With regard to properties, including long staple Indian cotton, Atlantic argued that it is the first time that this issue has been brought to its attention as being a problem. Atlantic argued that, if imports were of better quality, subjectively speaking, the buyers, as with most products, presumably would be happy to pay more for them. But that is not the case here.

Regarding the ability to price competitively vis-à-vis the subject yarns, Atlantic argued that it has demonstrated that it has sold yarn in 2002 at comparable and competitive prices. Atlantic also made reference to a previous Tribunal decision where it stated that “although price may be a consideration in determining whether a domestic fabric is substitutable for imported fabrics, it has not been the Tribunal’s practice to determine substitutability solely on the basis of price.”¹⁸ Atlantic submitted that this would apply to yarns in this particular case.

Atlantic argued that it has demonstrated the significant financial implications of removing the tariff concession and that, even if one were to reduce these estimates, the financial cost to Atlantic would still exceed by far the \$1.5 to \$2 million of forgone duties. Atlantic submitted that its yarn sales are going to be revenues that are maintained here in Canada, not revenues that are paid to offshore producers.

With regard to the costs to the users should duties be re-imposed, Atlantic argued that there is no certainty that the price of the subject yarns or Atlantic’s yarns would increase by up to the 8 percent duty. Atlantic argued that this should be kept in perspective when assessing the cost impact under this scenario. Atlantic also argued that, should there be a yarn price increase, it must be borne in mind that a 4 percent increase in the cost of yarn has only a 1 percent impact on the cost of garments.

Atlantic argued that, in terms of the impact zone of its decision, the Tribunal should only consider non-*NAFTA* yarns. Moreover, Atlantic submitted that three of the companies represented at the hearing are profitable. With respect to Main’s situation, Atlantic submitted that it had already moved 25 percent of its

18. *Report to the Minister of Finance: Reconsideration of Recommendation Regarding Certain Woven Fabrics of Cotton* (6 October 2000), TR-99-003A (CITT) at 4.

operations offshore, even while the tariff concession was in place, and that Main is possibly considering now, for any number of reasons, the relocation of 50 percent more of its operations.

Atlantic argued that the expiry of the tariff concession will not change the impact that a number of factors, i.e. the tough economic times, the inability to pass on cost increases, the LDC initiative, have had on yarn pricing. Atlantic also argued that Quebec has not substantiated its estimates that the re-imposition of duties would cost it 4,000 jobs.

Finally, Atlantic submitted that, should the Tribunal decide to recommend an extension of the tariff relief, it should consider a period of no longer than 18 months, since Atlantic has established during the past 18 months that it can provide substitutable and competitively priced yarns.

ANALYSIS

In considering the appropriateness of recommending the renewal, amendment or termination of the tariff relief, the Tribunal was mindful of its mandate, which requires that any recommendation should ultimately maximize net economic gains to Canada. In that context, the Tribunal focussed on two specific issues:

- the availability of identical or substitutable ring-spun yarns from domestic producers and their comparability with the subject yarns; and
- the impact on domestic producers, users and importers of ring-spun yarns (i.e. the effect on sales, prices, profitability and employment) should the tariff relief order be renewed.

As noted previously, the tariff relief covers:

- certain combed or carded ring-spun cotton and polyester/cotton yarns, measuring 190 decitex or less (31s and finer), for use in the manufacture of knitted fabrics or knitted garments;
- certain combed or carded ring-spun cotton two-ply yarns, measuring less than 125 decitex per single yarn (finer than 47s), for use in the manufacture of knitted fabrics or knitted garments; and
- certain combed ring-spun polyester/cotton yarns, measuring 492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s), for use in the manufacture of children's knitted wear.

Table 2 shows the volume, value and unit values of the total imports of the subject yarns reported by Statistics Canada for 2000, 2001, 2002 and the first six months of 2003 compared to the same period in 2002. After declining to approximately 11 million kilograms in 2001, the volume of imports of the subject yarns returned, in 2002, to its 2000 level of approximately 13.5 million kilograms, valued at \$50.1 million. Carded and combed ring-spun yarns, measuring 190 decitex or less (31s and finer), accounted for close to 100 percent of the total imports in volume in 2002, up from 97 percent recorded in 2000. Combed ring-spun yarns accounted for 61 percent of the total imports in volume reported in 2002. In general, the average value for duty for the subject yarns declined between the year 2001 and the first six months of 2003.

	2000	2001	2002	January-June	
				2002	2003
VOLUME (000 kg)					
Carded					
190 decitex or less (31s and finer)	4,780	4,520	5,240	2,681	2,693
Combed					
190 decitex or less (31s and finer)	8,286	6,217	8,210	4,795	3,336
492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s)	418	242	100	45	42
Total	13,484	10,979	13,550	7,521	6,071
VALUE FOR DUTY (\$000)					
Carded					
190 decitex or less (31s and finer)	17,738	16,512	16,517	8,616	8,128
Combed					
190 decitex or less (31s and finer)	35,985	27,970	33,257	19,478	13,890
492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s)	1,374	808	349	147	124
Total	55,097	45,290	50,123	28,241	22,142
UNIT VALUE FOR DUTY (\$/kg)					
Carded					
190 decitex or less (31s and finer)	3.71	3.65	3.15	3.21	3.02
Combed					
190 decitex or less (31s and finer)	4.34	4.50	4.05	4.06	4.16
492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s)	3.29	3.34	3.49	3.27	2.95
Weighted Average	4.09	4.13	3.70	3.76	3.65

Source: Statistics Canada.

The Tribunal first notes that Atlantic has established a very modern and efficient yarn producing facility and, in a very short time, has developed a market for a wide range of ring-spun yarns in the coarser counts. The Tribunal also recognizes that Atlantic's high-quality operation has been a significant force in creating and diversifying employment in a region of high unemployment.¹⁹

The Tribunal further notes that, when Atlantic made a commitment to build its plant in Pokemouche, it evidently had knowledge of the prevailing domestic and international market conditions, including the tariff relief that is now being examined, and established its facility to operate in that context. Atlantic is now attempting to change the context by departing from the consensus achieved in 1996 between the spinners and the knitters. While it is a legitimate pursuit, in the Tribunal's view, it carries the potential for damage to a vulnerable knitting industry, including Atlantic's customers or potential customers for the subject yarns.

At the start of this review, Atlantic submitted that the tariff relief order should be allowed to expire as scheduled, since it has the ability and the capacity to produce identical or substitutable yarns. However, during the course of the hearing, Atlantic revised its earlier position and proposed that the continuation of

19. *Transcript of Public Hearing*, 9 September 2003 at 392-94.

tariff relief apply only to: (1) combed or carded ring-spun cotton yarns, measuring 179 decitex or less (33s and finer), for use in the manufacture of knitted fabrics or knitted garments; (2) combed or carded ring-spun polyester/cotton yarns, measuring 190 decitex or less (31s and finer), for use in the manufacture of knitted fabrics or knitted garments; and (3) combed ring-spun polyester/cotton yarns, measuring 492 decitex, 328 decitex and 246 decitex (12s, 18s and 24s), for use in the manufacture of children's knitted wear.²⁰

It is also apparent from the evidence that the knitters have also responded to the changes in their environment and, in at least one major instance, have made large investments to modernize and automate equipment.²¹ Increasing capital investments have allowed the knitters to remain competitive internationally. While it may lead to reduced employment per unit of production, in at least one case,²² growth in production has been accompanied by growth in employment. Nevertheless, bankruptcies and company failures in recent years indicate the precariousness of the knitting industry overall and the intense pressures under which it operates. In essence, the knitters supported the continuation of the tariff relief because such relief has enabled them to maintain their production base in Canada and has enabled them and their customers to remain competitive in the face of increasing imports of finished garments.

Against this background, the Tribunal examined four key factors: (1) the domestic market conditions of the knitting industry; (2) the international environment; (3) Atlantic's ability to supply the market since the Tribunal's report of May 2002; and (4) the net economic gains to Canada.

Domestic Market Conditions of the Knitting Industry

During the Tribunal's last review, users and importers argued that, should duties be re-imposed, their operations would be adversely affected, since they would not be able to pass on this extra expense to their customers in a competitive environment where price is the controlling factor in purchasing decisions. From the evidence in the current proceedings, it is clear that this continues to be the case. According to Manoir Inc., the concentration of retailers in the market has changed the playing field.²³ "Wal-Mart has set the bar and they are looking at reductions all the time".²⁴ The Nalpac Company also testified that, for at least three and a half years, the company has not been able to pass on any increases in raw material costs to its customers.²⁵ In this regard, the Tribunal agrees that, in today's climate, retailers are increasingly consolidated and, therefore, dictate prices and may refuse to accept increases. This reduces or eliminates the apparel industry's ability and willingness to accept price increases from the knitters and, in turn, the knitters' flexibility in dealings with yarn suppliers. Atlantic acknowledged that, in the present market environment, it is very difficult to pass cost increases downstream.²⁶ It is evident to the Tribunal that the knitters are very sensitive to the price of their yarn inputs.

International Environment

The international environment in which Atlantic and the knitting and apparel industries operate has become increasingly competitive. Within this context, Atlantic has continued to benefit from certain provisions of *NAFTA*, whereby the knitters and weavers, using Atlantic's ring-spun yarns in the coarser counts, are able to produce and export, duty-free, fabric and garments of Canadian origin to the

20. Manufacturer's Exhibit A-3, Administrative Record, Vol. 5.

21. *Transcript of Public Hearing*, 8 September 2003 at 174.

22. *Ibid.* at 185-86.

23. *Ibid.* at 120.

24. *Ibid.* at 119.

25. *Ibid.* at 119-20.

26. *Transcript of Public Hearing*, 9 September 2003 at 295.

United States and Mexico. However, the Tribunal heard evidence²⁷ to the effect that some of the benefits of *NAFTA* have been stripped away by the *CBI* and the *CBTPA*.²⁸ Although they existed during the Tribunal's previous review of this matter, it seems that, because of these trade preference programs, a further weakening in demand for Canadian products has taken place and that Canada's export potential has been undermined.

The knitting industry submitted that Canada's recent LDC initiative²⁹ has further increased the pressure on Canadian textile and apparel producers through low-priced imports. In this regard, information was provided to the Tribunal that indicated that imports of apparel from the 48 LDCs, while still relatively small in total volume, increased in value by 68 percent during the first six months of 2003 over the same period a year earlier.³⁰ The Tribunal is also of the view that the re-imposition of duties on the subject yarns would create a tariff anomaly. For example, a yarn made in India would be dutiable if exported directly to a Canadian manufacturer of fabrics or apparel, but duty-free if imported after being transformed into fabric in a third country or into apparel in an LDC.

The textile and clothing industries also face other international pressures. According to some participants³¹ at the hearing, the elimination of quotas³² on imports of textiles and clothing as of January 1, 2005, will exacerbate the situation. Moreover, the recent admission of China as a WTO member and its increasing penetration of world markets for both textiles and clothing are significant factors. In this regard, the Tribunal notes that China is now the leading supplier of Canadian imports of all knitted apparel, having increased its shipments from \$230 million in 1998 to \$560 million in 2002.³³

Furthermore, the knitting industry submitted that its customer base has been weakened by recent exchange rate trends, as the Canadian dollar has risen in relation to the U.S. dollar. In this connection, Main indicated that the pegging of China's currency to the U.S. dollar has added pressure on the Canadian manufacturing industry. Suppliers in China enjoy a pricing advantage, in that the strength of the Canadian dollar relative to the U.S. dollar has made Canadian exports more expensive in the United States.³⁴ It was also reported that poor cotton crops in India and Pakistan in 2003 would increase costs and possibly affect the availability of offshore raw materials,³⁵ thus creating another element of uncertainty.

Atlantic's Ability to Supply the Market

In May 2002, the Tribunal recommended that tariff relief be extended for an 18-month period, with the view that "[t]his should provide Atlantic with sufficient time to vigorously pursue the subject yarn business and demonstrate to potential users that it can provide yarns at a competitive price that would meet their requirements."³⁶ Atlantic may have assumed that the Tribunal, in making this statement, was establishing conditions, exclusive of any others, that, if successfully met, would automatically lead to a

27. *Transcript of Public Hearing*, 8 September 2003 at 88, 90, 108, 229-30.

28. *Supra* note 13.

29. *Supra* note 12.

30. Importers' Exhibit G-1, Updated Appendix 5, Administrative Record, Vol. 5.1.

31. *Transcript of Public Hearing*, 8 September 2003 at 82, 89.

32. As part of the WTO Uruguay Round commitments, Canada is a party to the *Agreement on Textiles and Clothing*, which eliminates the system of quantitative restrictions (quotas) on imports of textiles and clothing over a 10-year implementation period ending on January 1, 2005.

33. Importers' Exhibit G-1, Appendix 3, Administrative Record, Vol. 5.1.

34. *Transcript of Public Hearing*, 8 September 2003 at 152.

35. *Transcript of In Camera Hearing*, 9 September 2003 at 112, 139-40.

36. *Report to the Minister of Finance: Review of Recommendation Regarding Certain Ring-Spun Yarns* (3 May 2002), TA-2001-001 (CITT) at 24.

recommendation that the tariff be reinstated on the subject yarns. This is not the case. In any event, the Tribunal is not convinced that such “pre-requisite conditions” have, indeed, been met by Atlantic.

First, the Tribunal does not doubt that Atlantic has vigorously pursued its ring-spun yarn business in the coarser counts. With respect to the finer counts, the Tribunal notes that Atlantic has made additional investments in combing equipment and that it has commenced production of ring-spun yarn in count 32/1. However, the Tribunal has not seen evidence of a clear marketing strategy in respect of the subject yarns. Moreover, as noted above, Atlantic significantly changed the terms of its request for full termination of the tariff relief so that it ultimately encompassed only a narrow band of the yarns currently subject to tariff relief.³⁷ In thus amending its request, Atlantic acknowledged that, in the finer yarns, it was planning to compete only in the count size 32/1. This leads the Tribunal to believe that Atlantic does not see itself in the market for finer yarns and, in the Tribunal’s view, casts doubt on any claim that Atlantic is vigorously pursuing “the subject yarn business”.

Second, since the Tribunal’s recommendation of May 2002, Atlantic did not, in the Tribunal’s view, “demonstrate to potential users that it can provide yarns at a competitive price that would meet their requirements.” In this regard, the three essential elements to be considered are the ability to supply, price competitiveness and the satisfaction of users’ requirements.

Because Atlantic has chosen to concentrate on 32s and does not see itself providing finer yarns in the foreseeable future, the Tribunal concludes that Atlantic’s ability to make the full range of the subject yarns has not been demonstrated and is in question for the future. In its recommendation of May 2002, the Tribunal clearly stated that, in demonstrating their ability to produce identical or substitutable products, “domestic producers must provide evidence to support a conclusion of imminent production, such as orders on hand and actual sales”.³⁸ On the basis of the evidence, there are a variety of factors, such as the price of cotton and conditions of sales, that can affect the prices of the subject yarns at a given time. Although Atlantic provided evidence³⁹ that showed that some of its pricing for smaller volumes (less than a container load) of 32s was comparable or within a reasonable range, which may suggest price competitiveness, the Tribunal is not convinced that the yarns offered at these prices would satisfy the requirements of potential customers that buy container load volumes. Atlantic acknowledged that the knitters’ expressed preference for long staple cotton could be met by spinning U.S. pima cotton or long-staple California cotton,⁴⁰ but showed no desire to source these raw materials and seemed to suggest that this cotton would be available only at a premium.⁴¹ In the Tribunal’s view, this would result in the long-staple California yarn not being price competitive. Furthermore, testimony from the knitters was consistently to the effect that the yarns from Atlantic, when made up into textiles, did not meet their standards with respect to such attributes as suppleness, softness, drape and sheen.⁴² Thus, Atlantic’s fine yarns fail to satisfy the requirements of potential users.

37. Atlantic estimated that 32s represented approximately 50 percent of the market for combed or carded ring-spun cotton yarns. Accordingly, about 6 million kilograms of the subject yarns would be excluded from tariff relief (*Transcript of Public Hearing*, 9 September 2003 at 250-51).

38. *Supra* note 36 at 22.

39. Manufacturer’s Exhibit A-2A Revised (protected), Administrative Record, Vol. 6.

40. *Transcript of Public Hearing*, 9 September 2003 at 372-73.

41. *Ibid.* at 375.

42. *Transcript of Public Hearing*, 8 September 2003 at 204; Tribunal Exhibit TA-2003-001-K-1, paras. 8-10, Administrative Record, Vol. 5.1; Tribunal Exhibit TA-2003-001-J-1, para. 4, Administrative Record, Vol. 5.1.

Net Economic Gains to Canada

The Tribunal's decision to recommend the renewal, amendment or termination of the tariff relief is also based on the extent to which it considers that such tariff relief would provide net economic gains to Canada. It is clear from the evidence that both Atlantic and the knitters have made significant capital investments in their operations with the benefits from equipment purchases flowing mostly to offshore vendors. Atlantic indicated that Phase 1 has created more than 200 direct jobs in Pokemouche. This represents close to \$4 million in annual wage earnings⁴³ and possibly as much as \$16 million in the economy when indirect jobs are included.⁴⁴ On the other hand, the knitting and apparel industries in Quebec currently employ approximately 16,000 workers,⁴⁵ which represent a payroll of over \$445 million.⁴⁶ While over 50 percent of the employment in these industries is located in Quebec,⁴⁷ considerable activity related to these industries exists in other regions of Canada. These figures indicate that investments by the knitters and apparel manufacturers are tied to much higher levels of employment and resultant benefits to the economy than are investments by yarn spinners.

The Tribunal is of the view that, in the current climate, the increased cost of inputs to the knitters, even of a small magnitude, would likely lead to a significant loss of sales in an extremely competitive market. The knitters might close operations or potentially fail, leading not only to a loss of employment but also to the erosion of Atlantic's domestic customer base, thus damaging both industries. On the other hand, the Tribunal notes that Atlantic has established a firm base in non-subject yarns, including sales to users requiring *NAFTA* yarns⁴⁸ and is clearly competitive in these yarns. Therefore, in the Tribunal's view, Atlantic is less vulnerable to market pressures and, should duties be reinstated on the subject yarns, the potential loss of employment for the knitters is significantly greater than the potential loss of employment for Atlantic if tariff relief continues. The potential loss to the users of the subject yarns in the first year could be as high as 4,000 direct jobs,⁴⁹ when potential plant closures and the possible relocation of facilities offshore are combined. When indirect employment is considered, the impact increases significantly.

Atlantic indicated that it is competing with imports of non-subject yarns where duties are applied and that, should tariff relief be reinstated on the subject yarns, Atlantic would be as competitive in the finer counts as it is in the coarser counts.⁵⁰ Under this scenario, Atlantic submitted, it is the market that would determine whether prices would increase.⁵¹ As noted above, important changes have taken place since the last review, among them a more profound impact of the CBI, the LDC initiative and the increased concentration of retailing in Canada. Further changes will take place when all quotas are removed on January 1, 2005. Therefore, there does not seem to be any room in the knitters' margins to allow for any price increase of the yarns that would result if tariff relief were terminated.

The Tribunal also notes that users and importers of the subject yarns have received significant benefits from the tariff relief. On the basis of the import data reported by Statistics Canada, for 2000, 2001

43. Assumes full-time employment of 200 workers at \$10 per hour for 48 weeks.

44. New Brunswick indicated that a multiplier of 3.5 or 4.0 is used when estimating the economic spinoffs of indirect jobs (*Transcript of Public Hearing*, 9 September 2003 at 395).

45. *Transcript of Public Hearing*, 8 September 2003 at 234-35.

46. *Ibid.* at 241. Based on an annual salary of \$28,000.

47. *Ibid.* at 225.

48. *Supra* note 15.

49. *Transcript of Public Hearing*, 8 September 2003 at 240.

50. *Transcript of Public Hearing*, 9 September 2003 at 310-11.

51. *Ibid.* at 311.

and 2002, primary direct benefits of tariff relief on the subject yarns were approximately \$4.5 million, \$3.1 million and \$3.5 million respectively.⁵²

On the basis of the evidence, it is clear that, in today's trade environment, users and importers need to reduce their costs, thereby enabling them to maintain their competitive position in a very price-sensitive marketplace. In this respect, it is evident to the Tribunal that tariff relief has been very beneficial for users of the subject yarns. Moreover, the Tribunal is of the view that a degree of stability and certainty in the marketplace must be provided to users of the subject yarns. Consequently, the Tribunal recommends that tariff relief on the subject yarns be provided for an indeterminate period of time. With regard to the current exclusion of certain knitting yarns from the purview of the textile reference, the Tribunal is of the view that this issue rests entirely within the Minister's authority.

RECOMMENDATION

In light of the foregoing, the Tribunal hereby recommends to the Minister that tariff relief, as provided for certain ring-spun yarns by tariff item Nos. 5205.14.20, 5205.15.20, 5205.24.20, 5205.26.20, 5205.27.20, 5205.28.20, 5205.35.20, 5205.46.20, 5205.47.20, 5205.48.20, 5206.14.10, 5206.15.10, 5206.24.10, 5206.25.10, 5509.53.10, 5509.53.20, 5509.53.30 and 5509.53.40, be continued beyond December 31, 2003, for an indeterminate period.

James A. Ogilvy
James A. Ogilvy
Presiding Member

Richard Lafontaine
Richard Lafontaine
Member

Meriel V.M. Bradford
Meriel V.M. Bradford
Member

52. Imports of the subject yarns from the United States and Mexico were excluded from this analysis.