

# **REPORT TO THE MINISTER OF FINANCE**

## **REVIEW OF RECOMMENDATION REGARDING WOVEN FABRICS KNOWN AS “ARMANI GABARDINE”**

**FEBRUARY 26, 1998**

**REVIEW NO.: TA-97-001**

Tribunal Members:	Robert C. Coates, Q.C., Presiding Member Arthur B. Trudeau, Member Raynald Guay, Member
Research Director:	Réal Roy
Research Manager:	Richard Cossette
Counsel for the Tribunal:	Shelley Rowe
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 October 21, 1997, the Canadian International Trade Tribunal (the Tribunal) gave notice that it was reviewing its recommendation to the Minister of Finance (the Minister) in Request Nos. TR-94-011 and TR-94-019 (Château Stores of Canada Ltd. and Hemisphere Productions Inc.), as implemented by Order in Council P.C. 1996-630 dated April 30, 1996, which added Code 4263<sup>1</sup> to the schedule to the *Customs Duties Reduction or Removal Order, 1988*, made by Order in Council P.C. 1987-2738 dated December 31, 1987.<sup>2</sup> Tariff item No. 5515.11.20 covers five-harness satin weave fabrics, containing 65 percent by weight of polyester staple fibres and 35 percent by weight of viscose rayon staple fibres, with a twist exceeding 1,000 turns per metre, of a weight of 255 g/m<sup>2</sup> or more but not exceeding 275 g/m<sup>2</sup>, for use in the manufacture of women's waistcoats (vests), trousers, skirts, dresses, shorts, jackets or blazers and men's waistcoats (vests), trousers, jackets or blazers (the subject fabrics). Tariff item No. 5515.11.20 is scheduled to expire on April 30, 1998.

The notice of review was distributed and published in the November 1, 1997, edition of the *Canada Gazette*, Part I.<sup>3</sup>

As part of the review, the Tribunal's research staff sent a questionnaire to potential domestic producers of identical or substitutable fabrics. A questionnaire was also sent to firms identified as importers and users of the subject fabrics. A letter was sent to the Department of Foreign Affairs and International Trade requesting information on any quantitative import restrictions on the subject fabrics. Letters were also sent to a number of other government departments for information and advice.

A staff investigation report, summarizing the information received from these government departments and firms that responded to the Tribunal's questionnaires, was provided to interested parties that had filed notices of appearance for the review, i.e. Tribal Sportswear Inc. (Tribal), the Canadian Textiles Institute (CTI), American Pant International Ltd. (American Pant) and Nygård International Ltd. Following distribution of the staff investigation report, Tribal and the CTI filed submissions with the Tribunal.

A public hearing was not held for the review.

## **SUMMARY OF THE TRIBUNAL'S 1995 RECOMMENDATION**

In its analysis in Request Nos. TR-94-011 and TR-94-019,<sup>4</sup> the Tribunal was concerned with the issues of, first, whether an identical or substitutable fabric was produced in Canada and, second, the impact of tariff relief on the domestic producers.

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1. Code 4263 was replaced, on January 1, 1998, by tariff item No. 5515.11.20 of the schedule to the *Customs Tariff*.

2. The wording of the Order in Council varies somewhat from that proposed by the Tribunal. For example, the twist factor was set at a higher level in the Order in Council (1,000 v. 960). As well, the word "fabric" was amended to "fabrics."

3. Vol. 131, No. 44 at 3457.

4. *Report to the Minister of Finance: Requests for Tariff Relief by Château Stores of Canada Ltd. and Hemisphere Productions Inc. Regarding Armani Gabardine*, Canadian International Trade Tribunal, September 19, 1995.

In assessing the issue of “fabric substitutability,” the Tribunal paid attention to a number of factors, including technical description, market acceptance, price and ability to supply. Regarding technical description, the Tribunal noted that the subject fabrics were woven from high-twist yarns, whereas Consoltex Inc. (Consoltex), a large domestic textile producer, did not supply a fabric woven from high-twist yarns. The evidence also showed that the desired characteristics of drapeability and feel of the subject fabrics were created because of the high-twist yarns.

On the question of market acceptance, the Tribunal was of the view that the historical and projected sales of the subject fabrics demonstrated that there was a demand and an identified market acceptance for the subject fabrics which were quite separate from the demand for allegedly substitutable domestic fabrics.

On the matter of price, the Tribunal observed that the landed price of the subject fabrics was notably higher than the price of domestic fabrics. Further, similar end products made up of the subject fabrics and a domestic fabric, such as skirts, had different price points. The Tribunal stated that the fact that domestic garment manufacturers were willing to pay more for a particular fabric tended to support the argument that domestic fabrics were not directly substitutable.

On ability to supply, the Tribunal noted that mere assertions made by the domestic producers of the potential ability to supply a certain fabric were not a sufficient reason not to grant tariff relief.

In summary, the Tribunal found that the domestic fabrics provided only a limited degree of substitutability for the subject fabrics.

This limited degree of substitutability was taken into account by the Tribunal in assessing the benefits and costs associated with tariff relief. Overall, the Tribunal was of the view that the estimated benefits provided by the tariff relief would, in the short term, exceed, by a high margin, any costs that might be incurred by the industry as a result of granting the tariff relief.

In light of the foregoing, the Tribunal recommended that the customs duties on importations of the subject fabrics be removed for a period of two years.

### **PRODUCT INFORMATION**

In Request Nos. TR-94-011 and TR-94-019, the subject fabrics were referred to as “Armani Gabardine.” The name “Armani Gabardine” is an internal industry name which was created simply to identify these fabrics. Users of these fabrics never use the “Armani” name in any public promotional way. Moreover, Revenue Canada’s analysis determined that the subject fabrics were not a gabardine, but were actually satin weave fabrics.

The separate qualities of polyester and rayon enhance each other when the two fibres are combined. The polyester adds its qualities of wrinkle-resistance, crease and shape retention and insensitivity to moisture to the rayon qualities of strong fibre, excellent absorbency, uniformity, lack of static cling, versatility, performance ability, much like fine cotton, and a high receptiveness to a wide variety of dyes and special finishes. The use of fabrics made of high-twist yarns provides added benefits of a soft feel and better drapeability.

Satin weave is one of the basic weaves, in which the face of the fabric is formed almost completely of warp or filling floats produced in the repeat of the weave. This is achieved by squaring the points of intersection as evenly and widely as possible. The weave produces a fabric with a characteristic smooth surface, employing a considerably greater number of yarns in the set of threads that form the face. The satin weave produces smooth, lustrous fabrics with relatively long floats of the warp.

Users that responded to the Tribunal's questionnaire indicated that the subject fabrics are currently used in the manufacture of ladies' pants, skirts and jackets, and men's dress pants.

## **REPRESENTATIONS**

### **Users of the Subject Fabrics**

#### Original Requesters

One of the original requesters of tariff relief on the subject fabrics, Château Stores of Canada Ltd. (Le Château), indicated to the Tribunal that it was withdrawing from the proceedings during the course of the review. Le Château noted that, at the time that it originally sought tariff relief, it was heavily importing the subject fabrics, and it believed that demand for the subject fabrics would continue to be strong. It further stated that, although tariff relief was granted, it was granted too late, i.e. after its imports had ceased. As for the future, Le Château does not expect to use the subject fabrics.

Hemisphere Productions Inc. (Hemisphere) was the other original requester of tariff relief on the subject fabrics. During the course of the review, Hemisphere indicated that it no longer had any interest in pursuing continued tariff relief, as it no longer used the subject fabrics.

#### Tribal

Tribal, a designer and manufacturer of ladies' sportswear, states that it is open to using domestic fabrics that have the same physical characteristics and price as the subject fabrics. However, it argues that there are currently no domestic producers that can provide a similar fabric with the same level of feel and drapeability and at a similar price as the subject fabrics.

Tribal argues that the reinstatement of the duty will translate into higher costs to its customers and to the consumer. Moreover, the re-imposition of the tariff will definitely impose higher costs on exports to the United States of apparel made from the subject fabrics.

Tribal supports the continuation of tariff relief and adds that tariff relief has enabled it to offer better pricing on products made from the subject fabrics to its Canadian and US customers. Tariff relief is also argued to have had a positive impact on Tribal's own domestic production and that of outside contractors, resulting in increased domestic employment and investment in the Canadian economy.

Tribal argues that, if tariff relief is extended beyond April 1998, it expects a continued positive impact on the Canadian economy through increased employment. On the other hand, if tariff relief is terminated, Tribal contends that the price of the subject fabrics will rise and that consumers in Canada and the United States will pay more for their garments. As well, Tribal argues that it will not be as competitive and that this will have a negative impact on its production and employment.

In response to the argument made by the CTI that there are no claims by users of a specific consumer demand for the subject fabrics, Tribal argues that most of its customers do ask for the subject fabrics on a year-round basis and that this is indicative of demand at the consumer level. Tribal also disputes the arguments made by the CTI that any shortfall in sales of goods made from the subject fabrics will be offset by sales increases in other fabrics by the same company or by other companies. Tribal responds that, in the market segment in which it does business, customers are very sensitive to price and quality and that any upward change in price or downward change in quality will adversely affect its sales. Further, because Tribal has yet to find a fabric similar to the subject fabrics, it does not foresee the possibility of balancing any loss of sales in the subject fabrics by increasing sales in other fabrics. Tribal does not find it feasible that other companies will be able to make up any demand that it is unable to supply.

### American Pant

American Pant, an importer and a small manufacturer of dress pants, argues that it is essential to its existence that tariff relief on the subject fabrics be continued. It notes that the subject fabrics are used in the production of garments for most of its customers. Should tariff relief not be continued, it argues that it will be in a difficult financial position, as its prices will rise, and that it will be priced out of the market.

### **Domestic Textile Producers**

The CTI identified Consoltex and Doubletex as possible manufacturers of fabrics identical to or substitutable for the subject fabrics. The companies were sent Tribunal questionnaires, but only Consoltex provided a response and made direct representations opposing the continuation of the tariff relief. The CTI, through its counsel, participated in the review and made representations on behalf of its members.

### Consoltex

Consoltex opposes any continuation of the tariff relief on imports of the subject fabrics. The company argues that sales and production of fabrics, which it identified in 1995 as being substitutable for the subject fabrics, have been adversely affected since the tariff measure has been in place. Consoltex adds that it has invested in equipment and product development in order to produce new fabrics made of high-twist yarns.<sup>5</sup> According to Consoltex, the development of these new fabrics will be damaged unless the tariff relief expires as scheduled.

### CTI

The CTI argues that any extension of the tariff relief in this case is unjustified and destructive. The CTI argues that the original petitioners (i.e. Le Château and Hemisphere) have not benefited from the tariff elimination and are not expecting to use the subject fabrics in the future, as evidenced by their withdrawal from the review proceedings.

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5. These recently developed products are made of polyester or polyester/rayon fibres, with a twist factor exceeding 1,000 twists per metre. They are identified under the names of Aristocrat, Regency, Infinity and Gateway.

The CTI contends that current users have not claimed that the consumer demands the subject fabrics, nor that the subject fabrics are fashion fabrics or indispensable fabrics for which there is a distinct non-seasonal demand.

The CTI argues that apparel fabrics made of high-twist yarns are now available from domestic production. For example, Consoltex is developing, introducing, producing and selling fabrics made of high-twist yarns. As well, the availability of such fabrics from domestic production is enhanced by other tariff items under which Canadian companies, such as Doubletex and others, may import such fabrics as greige for dyeing and finishing in Canada.

Regarding price, a factor considered important by the Tribunal in its 1995 recommendation to the Minister, the CTI argues that the price ranges of substitutable domestic and imported high-twist fabrics are now overlapping and that exchange movements are likely to offset much of the cost of the reinstated tariff.

Regarding ability to supply, another important factor considered by the Tribunal in 1995, the CTI argues that, since 1995, Consoltex has established a commercial supply of high-twist yarns, invested to facilitate the use of those yarns in weaving and introduced new high-twist fabrics. Further, the number of high-twist fabrics is expected to increase in the near future. Therefore, the CTI argues that the ability of Consoltex to supply fabrics made of high-twist yarns is no longer in doubt.

The CTI further argues that Consoltex is also prevented from introducing fabrics identical to or closely resembling the subject fabrics. It argues that the tariff relief creates a "no fly" zone for domestic fabric developers simply because normal profit margins are not obtainable on any new product for which duty-free imports can be readily substituted.

The CTI contests some of the analysis contained in the cost/benefit section of the staff report. First, it argues that apparel sales by the users and sales by the producers cannot simply be offset. Rather, the CTI argues that the gain in sales by Consoltex, if the tariff relief expires, will be achieved entirely from Canadian production, while any potential sales lost by Consoltex, should tariff relief be continued, will go entirely to imports.

Second, the CTI argues that overall sales of apparel will not change under any scenario. For example, any sales loss by Tribal, a user of the subject fabrics, will be supplied by other apparel manufacturers. Therefore, the beneficial sales projections of current users, in the event of continued tariff relief, ignore this compensating factor and are thus overstated.

Third, the CTI argues that not all duty savings should be ascribed to users, but should also be ascribed to such parties as exporters and importers, that are not users.

Finally, the CTI argues that staff, in presenting estimated costs and benefits for the 12-month period ending April 29, 1999, have understated the opportunity loss that Consoltex has estimated for the full year 1999.

The CTI concludes that, when all these factors are taken into account, costs to producers massively outweigh the benefits to users under a scenario of continued tariff relief.

## Other Submissions

The Department of Foreign Affairs and International Trade informed the Tribunal that Canada currently maintains quota restrictions on polyester/rayon fabric, comprised of blends of polyester staple and rayon staple or filament fibres (subcategory 37.1), imported from Taiwan. The bilateral agreement, which provides for this restriction between the Government of Canada and the Taiwanese Textile Federation, has been in place since 1987.

## ANALYSIS

In considering whether tariff relief should be continued, with or without amendment, the Tribunal will first look at whether all relevant factors which led it to recommend tariff relief continue to apply and, second, whether extending tariff relief under such conditions would continue to provide net economic gains for Canada.

In its 1995 recommendation to grant tariff relief on the subject fabrics, the Tribunal concluded that the domestic fabrics provided only a limited degree of substitutability for the subject fabrics and that the net economic benefits of granting tariff relief, in the short term, would be positive.

In brief, the Tribunal reached its decision of limited fabric substitutability on the basis of the distinct characteristics of the subject fabrics made of high-twist yarns and the lack of domestic supply of these fabrics, the distinct demand and market acceptance for the subject fabrics and the fact that the landed price of the subject fabrics was notably higher than the price of allegedly substitutable domestic fabrics. Regarding the ability to supply, the Tribunal was not convinced that the domestic producers' mere assertions of the potential ability to supply a given fabric were sufficient grounds to deny the request for tariff relief.

In the latter instance, the evidence indicated that Consoltex had been approached by Le Château to supply high-twist fabrics similar to the subject fabrics, but that it did not have a supply of high-twist yarns. Doubletex, on the other hand, claimed that it did produce a number of substitutable fabrics. However, the Tribunal noted that none of the fabrics identified by Doubletex had the same construction as the subject fabrics nor did they fall within the weight range identified in the product definition.

Significant changes have occurred since the Tribunal's recommendation. One important change is that substitutable apparel fabrics are now available from domestic production. Indeed, Consoltex has recently begun developing, producing and selling fabrics produced from high-twist yarns. As well, the availability of such fabrics from domestic production is enhanced by other tariff items under which Canadian companies, such as Doubletex, may import similar fabrics in greige form for dyeing and finishing in Canada.<sup>6</sup>

Regarding relative prices, the Tribunal found, in 1995, that the subject fabrics were being imported at higher prices than the domestic fabrics which Consoltex considered substitutable and that this price difference tended to indicate to the Tribunal that the two fabrics were not direct substitutes. Since the Tribunal's recommendation, the average export price from Taiwan has trended downward and future

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6. Some of these fabrics, in bleached or unbleached form, are covered by tariff item No. 5515.11.10, formerly Code 4416, which implemented the Tribunal's recommendation in *Report to the Minister of Finance: Requests for Tariff Relief by Doubletex Regarding Unbleached or Bleached Woven Fabrics*, Request Nos. TR-95-057 and TR-97-058, October 24, 1996.



reductions are expected, given a decline in the Taiwanese currency. Imports from the People's Republic of China and other countries have also entered at prices well below those of the Taiwanese goods. Meanwhile, sales from domestic production have been made at higher price points. As a result, the price ranges of substitutable domestic and imported high-twist fabrics are now overlapping. This bridging of price differences is one indicator that suggests to the Tribunal that the two fabrics are now substitutable.

Another change that has occurred relates to the domestic industry's ability to supply substitutable fabrics. The evidence shows that Consoltex has now: (1) established a commercial supply of high-twist yarns imported from the Far East; (2) invested<sup>7</sup> in facilities for the weaving of those yarns; and (3) introduced four fabrics produced from such high-twist yarns. Moreover, based on the evidence, the Tribunal is persuaded that Consoltex will continue to develop and have available for sale other fabrics produced from high-twist yarns in the near future.

The apparent Canadian market for the subject fabrics and alleged substitutable fabrics in 1994 was estimated to be approximately 2.8 million linear metres, with projected imports for 1995 to increase significantly over 1994. This increase in demand by the users of the subject fabrics has not materialized. In fact, the current estimated market, based on information on record, is actually lower than that reported for 1994.<sup>8</sup> As for the original requesters, Le Château and Hemisphere, their projections of their own demand and sales have not materialized, as evidenced by their withdrawal from the proceedings and the fact that they no longer import and sell apparel produced from the subject fabrics.

The Tribunal has examined the anticipated effects of continuing tariff relief for the 12-month period after the expiry date of tariff item No. 5515.11.20. The primary direct benefits of continuing the tariff relief for this one-year period, based on the historical level of imports of the subject fabrics and the projections of users of the subject fabrics, would amount to approximately \$1 million, assuming the applicable MFN duty rate and that there would be no further changes to the import volumes and prices for importers that did not provide specific projected import data.

However, offsetting these benefits of continued tariff relief, there would be significant costs to domestic producers of substitutable fabrics. In its 1995 recommendation, based on a scenario of limited degree of substitutability, the Tribunal viewed the costs to domestic producers to be much less than the expected benefits to users. However, as noted earlier, the situation with regard to domestic supply has changed significantly. The ability of Consoltex to supply fabrics made of high-twist yarns is no longer in doubt.

Consoltex argues that, with continued tariff relief, it would incur significant losses in the form of reduced sales and reduced margins on the company's sales of its newly developed high-twist fabrics and its "surviving" line of other fashion fabrics for 1998. It also argues that it would be faced with a complete loss of sales for other new high-twist fabrics which it plans on introducing and selling in calendar year 1999.

The Tribunal is not persuaded that the "surviving" fashion fabrics made by Consoltex from non-high-twist yarns are likely to be seriously affected by any continuation of tariff relief, for the same reasons as noted in its 1995 recommendation. However, it is persuaded that the continuation of tariff relief

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7. The actual amount is protected information.

8. Because of the limited number of market participants, the total estimated market for the 14-month period ending June 30, 1997, is protected information.

will cause Consoltex to incur significant actual and potential losses on the new generation of fabrics made from high-twist yarns. Overall, the combined costs to Consoltex of continuing tariff relief on recently developed fabrics made from high-twist yarns and on proposed fabrics also based on high-twist yarns are estimated to exceed any benefits to users of the subject fabrics provided by the continued tariff relief.

In summary, the Tribunal finds that the domestic industry has made serious efforts to develop and produce substitutable fabrics for the subject fabrics and plans on developing and producing other substitutable fabrics over the short term. Because the continuation of tariff relief would result in significant costs to the domestic textile industry, the Tribunal believes that continued tariff relief would not maximize net economic gains for Canada. Therefore, the Tribunal recommends that the tariff relief, as covered by tariff item No. 5515.11.20, not be extended beyond April 30, 1998.

### **RECOMMENDATION**

In light of the foregoing, the Tribunal hereby recommends to the Minister that tariff relief not be extended beyond April 30, 1998, on importations from all countries of five-harness satin weave fabrics, containing 65 percent by weight of polyester staple fibres and 35 percent by weight of viscose rayon staple fibres, with a twist exceeding 1,000 turns per metre, of a weight of 255 g/m<sup>2</sup> or more but not exceeding 275 g/m<sup>2</sup>, for use in the manufacture of women's waistcoats (vests), trousers, skirts, dresses, shorts, jackets or blazers and men's waistcoats (vests), trousers, jackets or blazers.

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