HOUSE OF COMMONS
CANADA

DUTY REMISSION AND THE ZERO-RATING OF TARIFFS ON TEXTILE INPUTS: THE CANADIAN APPAREL INDUSTRY

REPORT OF THE STANDING COMMITTEE ON FINANCE

Roy Cullen, M.P.
Chair

May 2004

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THE STANDING COMMITTEE ON FINANCE

has the honour to present its

FOURTH REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied the question of Duty Remission and the Zero-rating of Tariffs on Textile Inputs: the Canadian Apparel Industry and has agreed to report the following:

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DUTY REMISSION AND THE ZERO-RATING OF TARIFFS ON TEXTILE INPUTS: THE CANADIAN APPAREL INDUSTRY

During the House of Commons Standing Committee on Finance's examination of Bill C-21, An Act to amend the Customs Tariff, in the Third Session of the Thirty-Seventh Parliament, witnesses from the apparel industry shared their views about Canada's duty-remission program and the level of tariffs on textile imports. While witnesses supported the Bill's intention to extend Canada's General Preferential Tariff (GPT) and Least Developed Country Tariff (LDCT) for a further ten years, they urged the Committee to consider the effects of the proposed legislation in the context of Canada's overall tariff regime. Specifically, they asked the Committee to examine the duty-remission orders covering the apparel industry — many of which are due to expire on 31 December 2004 — and, more generally, tariff levels on imported fabric inputs.

The Vice-Chair of Peerless Clothing and President of the Canadian Apparel Federation informed the Committee that "the existing and imminent tariff and quota challenges facing the apparel industry mean that the extension of the … tariffs, which is before [the Committee] in Bill C-21, cannot be done without also implementing a measure that will enable the Canadian apparel industry to compete." While the Committee agrees with this assessment, duty-remission orders and tariff levels lie outside the scope of Bill C-21. Because the duty-remission orders in question will expire shortly, the Committee has decided to issue this report, which summarizes the issues brought to our attention and makes recommendations that we believe will assist this important industry.

THE CANADIAN APPAREL INDUSTRY

According to Industry Canada, the apparel industry is the tenth largest manufacturing sector in Canada, with more than 93,000 employees working in 3,900 establishments. It accounts for 2% of Canada's total manufacturing gross domestic product (GDP), 4% of manufacturing investment and 4.4% of total manufacturing employment.[1] The President of the Canadian Apparel Federation told the Committee about the importance of the industry, indicating that "it draws on a large range of skills, including relatively low-skill and low-technology employment suitable for some new entrants to the Canadian labour force. In the urban areas, where the industry is concentrated, these entry-level jobs enable apparel companies to play an important role in socializing new entrants into the Canadian workforce.

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[1] Industry Canada, "Apparel," strategis.ic.gc.ca/epic/internet/inapparel-vetements.nsf/vwGeneratedInterE/home.

These entry-level workers develop their language and work skills, and they often move into more skilled jobs in the industry or in the broader economy." Moreover, we were told that the apparel industry's exports to the United States total approximately $3.5 billion.

Canadian apparel "manufacturing-importers" — firms that retain design and marketing control, and some production, in Canada, while complementing these activities and products with offshore production — play an important role in providing jobs for Canadians. The President of A&R Dress Company Inc. remarked that "[t]oday, all apparel stakeholders (including the Department of Finance, Industry Canada and the Department of Foreign Affairs and International Trade) agree that 'manufacturing-importers' represent one of the most vital sub-sectors in today's trading environment, and is one of the sub-sectors that is most likely to maintain employment in Canada."

Speaking on behalf of one such organization, the President and Chief Executive Officer of COMO Diffusion Inc. told the Committee that, within the manufacturing-importers industry, "manufacturers have found a way to blend domestic manufacturing with a certain amount of importation to maximize our overall results and to offset the attractiveness our retailing customers find in sourcing products on their own in the Far East — China, Thailand, and lesser-developed countries. The fact that we have to compete with these direct purchases and can find a way to do so while employing hundreds of Canadians is something I personally am very proud of, both in our company in particular and the industry in general."

DUTY REMISSION AND THE CANADIAN APPAREL INDUSTRY

In cases where Canadian companies require relief from tariffs — including changes to the country's tariff regime — the federal government has, in the past, provided duty remission to affected companies. Duty remission is the conditional or unconditional waiver, in whole or in part, of import duties or taxes on imported goods. According to the Department of Finance, duty remission "is generally introduced only in exceptional circumstances where a genuine need for tariff relief has been clearly demonstrated. Duty remissions are sometimes used to rectify short-term anomalies or inequities in the tariff structure."[2]

As shown in Table 1, the Canadian apparel industry is currently covered by several duty-remission orders, most of which are set to expire on 31 December 2004. These remission orders renewed remission orders put into place with the introduction of the Canada-United States Free Trade Agreement in 1989. The President of A&R Dress Company Inc. told the Committee that these remission

[2] Department of Finance, www.fin.gc.ca/gloss/gloss-d_e.html#duty-rem.

orders were introduced "largely as compensation for extremely stringent rules of origin, which restricted effective market access into the U.S. by Canadian apparel manufacturers."

Table 1: Canadian Apparel Industry Duty-Remission Orders Ending 31 December 2004

Remission order	Regulation no.	Registration date
Tailored Collar Shirts Remission Order, 1997	SOR/97-291	17 June 1997
Outerwear Greige Fabrics Remission Order, 1998	SOR/98-86	29 Dec. 1997
Shirting Fabrics Remission Order, 1998	SOR/98-87	29 Dec.1997
Outerwear Apparel Remission Order, 1998	SOR/98-88	29 Dec.1997
Blouses, Shirts and Co-ordinates Remission Order, 1998	SOR/98-89	29 Dec.1997
Outerwear Fabrics Remission Order, 1998	SOR/98-90	29 Dec.1997

Source: Library of Parliament.

According to the Regulatory Impact Analysis Statements filed by the Department of Foreign Affairs and International Trade when these regulations were published in the *Canada Gazette Part II*, the remission benefits provide Canadian manufacturers with annual duty savings of approximately $13 million for shirt makers, $18 million on imported women's blouses, shirts and co-ordinates, $5 million on outerwear apparel, $2 million on finished and greige outerwear fabrics, and $2 million on shirting fabrics.

Witnesses told the Committee that apparel manufacturing-importers would be negatively affected by the joint decisions to extend the Least Developed Country Tariff (LDCT) and the General Preferential Tariff (GPT) as proposed by Bill C-21 and the scheduled expiration of the duty-remission orders. These Canadian companies must compete against countries covered by the LDCT, and tariffs on the importation of some inputs place Canadian companies at a disadvantage with respect to their competitors in other countries. In an industry that depends so much on fabric — representing, according to the President of the Canadian Apparel Federation, "50% to 75% of total input costs" — any extra duties faced by the industry can be quite harmful. Witnesses told the Committee that the duty-remission orders have been a critical factor in their ability to compete with other countries' producers.

The President of A&R Dress Company Inc. told the Committee that without tariff relief, companies must pay duties on their raw-material inputs "while the same finished garments (made from the very same raw materials) enter Canada from LDC beneficiary countries duty-free and quota-free." According to the President, the company's duty costs would "rise by 25% overnight, and the disparity between the price that [it is] able to offer versus [its] LDC competitors [would] increase exponentially."

The situation faced by Canadian apparel manufacturers has been affected by the federal government's decision to widen the scope of the LDCT to give the 48 eligible countries duty-free access to the Canadian market, with the exception of supply-managed agricultural goods, effective 1 January 2003. In 2003, Canadian imports under the LDCT were valued at $408 million and accounted for 0.12% of total Canadian imports.[3] According to the President of the Canadian Apparel Federation, in 2003 Cambodian imports to Canada rose by 328%, to $83 million, while imports from Bangladesh increased by 115%, to $303 million.

Witnesses also spoke to the Committee about the effect of the continuing removal of quotas. The President and Chief Executive Officer of COMO Diffusion Inc. indicated that, "especially for product going into the United States, the challenges to Canadian manufacturers will be even greater, as many third-world countries will be able to flood America with garments at lower costs than those which are prevalent today." Similarly, the President of A&R Dress Company Inc. remarked that the company "is about to experience the perfect storm: the elimination of a vital tariff-relief program for A&R, and the extension of quota-free (and in many cases duty-free) access for [its] competitors."

Witnesses, including the President of A&R Dress Company Inc., told the Committee that the Department of Finance has demonstrated "an unwillingness to extend the remission order, which doesn't take into consideration materially altered conditions in the sector, such as the extremely permissive rules of origin under Canada's LDC program."

In the Committee's view, remission orders are, by their very nature, an incomplete and ad hoc method of addressing the needs of the entire Canadian apparel sector with respect to input costs: some textiles and sub-sectors are covered, while others are not. Moreover, we note the comments made by witnesses that the 31 December 2004 expiration date of the duty-remission orders is fast approaching, and companies need to make procurement and employment decisions in the immediate future. Consequently, it is vital that the federal government take immediate action to, at a minimum, maintain the current system. From this perspective, the Committee recommends:

RECOMMENDATION No. 1

That the federal government immediately extend, for a further seven years, the duty-remission orders covering the apparel sector that are set to expire on 31 December 2004.

[3] Department of Finance, "Bill C-21: An Act to amend the Customs Tariff," briefing book provided to the House of Commons Standing Committee on Finance, March 2003. See also House of Commons, *Debates*, 25 February 2004, 15:35 (the Honourable Denis Paradis, P.C., M.P.), available at: http://www.parl.gc.ca/37/3/parlbus/chambus/house/debates/018_2004-02-25/han018_1535-E.htm#Int-82444.

TARIFFS ON INPUTS AND THE CANADIAN APPAREL INDUSTRY

Duty-remission orders do not address the needs of all companies in the apparel industry, and have no effect on those manufacturers not covered by the remission orders. Witnesses told the Committee that the situation would be improved if apparel fabrics were permitted to enter Canada free of duty.

The Committee was told that because of tariffs on their inputs, Canadian apparel manufacturers are being penalized for situating part of their manufacturing base in Canada; were they to relocate to Mexico, they could avoid the tariff and ship the finished goods to Canada or the United States tariff-free. According to the President of Western Glove Works, one year ago his company employed 1,290 workers in Canada; today, that number is 587 and if duties on fabric are not relieved and if the situation continues into the future as it has in the past, in 18 months the company will employ 121 people. He told the Committee that this situation would not affect the company's revenues, remarking that it does not "need Canadian employment to be profitable. But there's a beauty and a wonderfulness about being able to manufacture and assemble a product in this country, and we're losing it rapidly."

Witnesses also indicated that many, if not most, of the fabrics to which these tariffs are applied are no longer manufactured in Canada. The Vice-Chair of Peerless Clothing told the Committee that the company must import 90% of its textiles. From an industrial policy point of view, the President of Western Glove Works — which can no longer access a domestic supplier of denim to make its jeans — noted that there is no reason for many of these tariffs, which he suggested were put in place many years ago to protect the Canadian textile industry from an influx of imports. In his view, even with the duties, the textile industry has changed to the point that the Canadian apparel industry, which used to be 70% domestically supplied, now domestically sources only 35% of its fabric inputs and the companies who are trying to be protected by those specific duties no longer exist.

Witnesses noted that, on 27 February 2004, the Minister of Industry, the Honourable Lucienne Robillard, committed about $26.7 million over the next three years in tariff reductions for the apparel industry. The President of the Canadian Apparel Federation informed the Committee that the Canadian apparel industry pays more than $110 million in duties on inputs each year. This initiative will remove about $9 million of these duties. In contrast, the federal government's elimination of duties on least-developed countries in the past year gave duty relief of about $100 million to imports of finished apparel from least-developed countries. In the President's view, "if the government could give $100 million of annual tariff savings to imported apparel, it should and could give the same amount of relief to Canadian apparel manufacturers. … [W]ithout tariff relief on fabrics and other inputs, we cannot eliminate the current tariff bias in favour of foreign apparel producers."

While the Committee believes that the action announced by Minister Robillard is a step in the right direction, more action is likely needed. Specifically, we believe that tariffs on inputs that are not — or no longer — manufactured in Canada have outlived their usefulness and, consequently, should be eliminated. It is for this reason that the Committee recommends:

RECOMMENDATION No. 2

That the federal government immediately end tariffs on inputs which are not produced domestically. Textile producers seeking continued tariff protection should be required to establish that they sell their products to Canadian apparel manufacturers.

With respect to the more general issue of tariffs affecting the Canadian apparel industry, the Committee feels that changes are required. Duty remission represents a second-best solution to the Canadian apparel manufacturers' situation. Moreover, there are other issues that are problematic, such as tariff differentiation on fabrics according to their end-use — or product differentiation — and the effect of tariff elimination on the domestic textile industry. We believe that the Canadian tariff regime is a subject that deserves more attention than was possible in this report and that has been given by us during our examination of Bill C-21. In our view, it is also a subject that requires the input of many stakeholders. Consequently, the Committee recommends:

RECOMMENDATION No. 3

That the federal government immediately undertake a study of temporary adaptation measures to enhance competitiveness, as well as the benefits and costs of eliminating tariffs on imports of fabric for use in the Canadian apparel sector, the types and quantities of products produced by the Canadian textile industry, and the practice of tariff differentiation on fabrics based on their end-use. The results of this study should be tabled in Parliament no later than 31 January 2005.

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee request that the government table a comprehensive response to this report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 18 to 22 including this report)* is tabled.

Respectfully submitted,

Roy Cullen, M.P.
Chair