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**STUDY OF THE IMPACT OF  
POTENTIAL FREE TRADE  
IN TEXTILES AND CLOTHING  
BETWEEN CANADA AND  
THE UNITED STATES**

**FINAL REPORT**

**Canada**



Government  
of Canada

Gouvernement  
du Canada

Textile and  
Clothing Board

Commission du  
textile et du vêtement



Government  
of Canada

Gouvernement  
du Canada

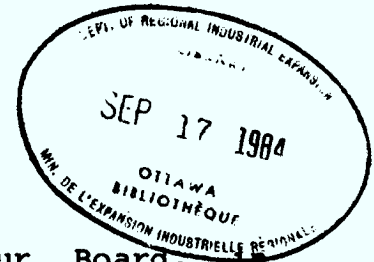
Textile and  
Clothing Board

Commission du  
textile et du vêtement

Ottawa, Canada  
K1A 0H5

August 17, 1984

The Honourable Edward C. Lumley, P.C., M.P.  
Minister of Regional Industrial Expansion  
Ottawa, Ontario  
K1A 0H5



Mr. Minister,

On June 6, 1983, you asked our Board, in conformity with Section 20 of the Act, to carry out an assessment of the impact of potential free trade between Canada and the United States for the textile and clothing industry sectors.

A preliminary report of the study was submitted to you on December 30, 1983. This preliminary report was a summary of the reactions of the participants who submitted briefs and/or appeared at hearings held by the Board across Canada.

We now have the honour and pleasure of submitting to you the Final Report of the study which you requested. This Final Report combines the results of research by the Board with the data obtained in the briefs and during the hearings. It assesses the chances of success of Canadian textile and clothing industries in a potential free trade area with the United States.

Yours sincerely,

Jacques St-Laurent  
Member

Otto E. Thur  
Chairman

Canada

TEXTILE AND CLOTHING BOARD

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OTTAWA, CANADA  
AUGUST 17, 1984

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## 1. INTRODUCTION

In his letter of June 6, 1983, the Minister of Industry, Trade and Commerce and of Regional Economic Expansion requested, pursuant to Section 20 of the Act creating the Textile and Clothing Board, that the latter undertake a study of the economic impact of the potential mutual elimination of tariff and non-tariff barriers to trade between Canada and the United States for textile and clothing products.

The Minister requested that the study should be aimed at determining the potential impact of the removal of barriers on productivity, competitiveness, investment, employment and national and regional industrial structures in Canada, while taking into account the existing institutional and corporate characteristics, but avoiding discussion of the negotiability of a free trade area or the international implications of such an arrangement. Finally, the Minister directed the Board not to present recommendations on the desirability or otherwise of such an arrangement with the United States.

On August 6, 1983, that is immediately after the reopening of plants following their annual holiday shutdown period, the Board published a notice in the Canada Gazette that it was undertaking this study, and distributed this notice to a large number of associations and firms in the textile and clothing sectors. The notice stipulated that written briefs on the subject be submitted to the Board not later than October 31, 1983, and that hearings relating to the study would be held in November of the same year.

The Board received 45 written briefs, and 74 participants<sup>(1)</sup> appeared before the Board during private hearings which were held between

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(1) See list in Appendix I.

November 7 and December 8, 1983 in Ottawa, Halifax, Montreal, Toronto, Winnipeg and Vancouver.

The Board also undertook additional research carried out either by its own personnel or by outside consultants.

A brief preliminary report was prepared immediately after the end of the private hearings and was forwarded to the Minister on December 30, 1983. The preliminary report summarized the positions taken by the participants in their written briefs and in the opinions expressed during the hearings.

This Final Report combines the results of research by the Board with the data obtained in the briefs and during the hearings. Its purpose is to assess the chances of success of the Canadian textile and clothing industries in a potential free trade area with the United States. These chances depend on the industries' competitive ability, and the present report concentrates on an analysis of the elements which determine it.

#### Definition and Rules of a Free Trade Area

The mutual elimination of tariff and non-tariff barriers leads to the establishment of a free trade area which can be sectoral or non-sectoral.

Such a free trade area implies free movement between the participating countries of the products covered by the agreement, on condition that they are manufactured within the participating countries.

It should be noted that a free trade area is not a customs union. In effect, a customs union implies that the participating countries agree on a unified customs tariff applied to imports from third countries, and on a common regulation of import trade. In this case products manufactured in the participating countries as well as imported products may circulate freely within the whole territory of the customs union, since importation of the latter was made under identical conditions regardless of the point of entry. On the other hand, a free trade area does not require that the member countries apply a common tariff and a common regulation of trade with third countries.

In the strict sense of the term, a free trade area is more limited in scope than an economic union. An economic union implies not only the free movement of products, but also of production factors and, as well, adoption of common economic, commercial, fiscal and social policies where supra-national organisms are required to oversee their integration. This is not the case in a free trade area.

Customs union and economic union thus represent higher degrees of integration of the economic entities in question than is the case for a free trade area.

A free trade area represents the form of integration which requires giving up the least amount of national sovereignty. If a free trade agreement for certain products is concluded between two countries, the participants remain free to establish their own tariff protection



and their own regulations for imports of all other products and for imports from all other countries. In the specific case of textile and clothing products this would mean that Canada and the United States could maintain customs tariffs and special measures of protection as they exist at present.

An agreement on any given form of market integration is normally irreversible. Indeed, it would be costly and useless to undertake the required structural adjustment for such integration if the agreement creating it could be cancelled later by any one of the participants.

Once it has been determined that the desired form of integration is that of a free trade area and not a customs union or economic union, product coverage and conditions of competition in these products must then be defined.

With regard to products, the agreement must clearly identify the products which will be traded freely. The continuous development of synthetic products tends to blur the exact line of demarcation between what is a textile product and what is not. Nevertheless, with regard to the request to the Board, textile and clothing products should comprise everything included in this category as defined by Section 2(f) of the Act creating the Textile and Clothing Board<sup>(1)</sup>.

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(1) Section 2(f) reads as follows:

"textile and clothing goods" includes

- (i) processed natural fibres and man-made fibres that are used in the production of any yarns and fabrics
- (ii) yarns and fabrics
- (iii) wearing apparel manufactured from any material excluding footwear and apparel manufactured primarily from fur, and
- (iv) products, not being wearing apparel, that are primarily made from yarns and fabrics."

The only change which would probably have to be made to this definition would concern fur garments. At present, these are excluded from the Board's mandate because they represent an industry sector which does very well against foreign competition and which has never required special measures of protection. But, in a different context, that is in a potential free trade area with the United States, there would be good reason to include fur clothing in the general category of clothing.

When the products which would circulate freely within the free trade area have been identified, rules must then be established regarding the origin of these products. While a large number of products are manufactured entirely within the participating countries, there are also others made from intermediate products imported from third countries. The participating countries must therefore come to an agreement on the "minimum national content" which will qualify a product as of domestic manufacture and thus allow it to move freely. These rules of origin can be established either by specifying the particular production process or processes to be carried out in the participating countries, or by specifying the proportion of production costs that must be incurred or value added in these countries.

A free trade area also requires a number of rules, some applying to the manufacturing firms, and others to the participating governments.

Competition rules for manufacturing firms deal with possible abuses arising from a position of dominance in the market (fixing of purchase or sale prices, limitation of production or markets), agreements among producers, or dumping practices.

Rules concerning the governments of the participating countries deal mainly with subsidies which could distort competitive patterns by favoring certain firms, certain regions or certain types of production. However, all subsidies need not necessarily be prohibited, since some of these could be compatible with the advantages of a free trade area if they are well defined and accepted by the participating countries.

#### GATT Provisions and Effects on Third Countries

Economic union of any kind produces repercussions on third countries. Within an area of free movement of goods the imports from member countries, being free of duty, have an advantage over imports from third countries which are still dutiable. The diversion of trade resulting from this will vary in importance according to the structural characteristics of the external trade of the countries creating the free trade area.

This trade diversion effect will be of limited importance if, before the creation of the free trade area, trade between the participating countries is already well developed and the products traded with all other countries differ in quality, content, style and price. In effect, if traditional trade between participating countries was already important before the establishment of a free trade area, the diversion effects after the arrangement will be minimal. If, in addition, the products imported from all sources were highly specialized by country of origin before free trade, they will likely not be seriously affected by the creation of a free trade area. In the textile and clothing sectors the products from various sources differ in terms of quality, design and price, and these differences are well defined. Consequently, there is very little interchangeability in the sources of importation of these products and the latter would likely not be affected by the creation of a free trade area.

Since the end of the Second World War, international trade has been governed by a negotiated international legal framework - the GATT. The Board believes it useful to recall at this point the main provisions of the GATT concerning free trade areas.

These provisions are contained in Article XXIV of the GATT(1). This article makes mention of free trade areas, but does not refer specifically to sectoral free trade areas.

This article reads in part as follows:

"8. For the purposes of this Agreement:

- (a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
  - (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,
  - (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;
- (b) A free trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories."

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(1) For more details on the subject see Rodney de C. Grey: "Legal/Institutional Aspects of a "Free Trade Area" for Textiles and Clothing between the U.S. and Canada", Textile and Clothing Board, Ottawa, 1984.

However, the GATT has already ratified a sectoral free trade agreement as a departure to this rule, but in accordance with Article XXV of the Canada-United States Automotive Products Agreement.

Article XXIV of the GATT stipulates that a free trade area exists when substantially all the trade between two or more countries in products originating in such countries takes place freely, without duties and other restrictive regulations of trade. The term "substantially" is not defined precisely, but at one time the representative of the European Economic Community had proposed that the condition "substantially" be considered as fulfilled when 80 per cent of the trade between two or more countries takes place without duties or other restrictions to trade.

Already close to 80 per cent of trade between Canada and the United States is carried out without duties or restrictive regulations. If the two countries were to agree on a sectoral free trade area covering not only textiles and clothing but several other industrial sectors, the resultant proportion of liberalized trade would largely exceed the above-mentioned 80 per cent.

In addition, the GATT provides for a possible transition period for the establishment of a free trade area. Also, when the European Free Trade Association (EFTA) was created, the GATT allowed limited recourse to safeguard clauses, to the application of anti-dumping duties and to other countervailing duties.

In summary, if the international legal framework does not provide specifically for the possibility of creating sectoral free trade areas, it also does not prohibit it, as long as certain conditions are met.

expenditures in Canada and in the United States in the last five years. The similarity in this distribution is remarkable. The only major difference concerns personal goods and services and medical care and health services, and this difference is mainly attributable to the fact that, in Canada, medical care and health services are for the most part paid for by governments, while in the United States they are an individual responsibility.

In general, the order of priority for consumers is fairly similar: in both countries clothing represents some 5 per cent of consumer expenditures. However, expenditures for clothing take a slightly greater share of consumer expenditures in Canada than in the United States. This spread is probably due more to a difference in climate than in prices. Climate for the whole of Canada is rigorous, while in the United States only the northern part of the country has similar weather conditions.

The position of the textile and clothing industries in overall economic activity can be assessed by examining gross domestic product and employment. Both of these indicators show that these industries play a proportionately similar role in the economies of both countries (Tables 2 and 3). In terms of production and employment, the two industries represent a sizeable contribution to overall manufacturing activity: they account for nearly 7 per cent of gross domestic product and 10 per cent of total employment in manufacturing.



Tables 2 and 3 also show that the relative decline in importance of the textile sectors in Canada closely parallels that in the United States. In the last ten years the gross domestic product in constant dollars for the three textile sectors showed some increase but it was less than that for total manufacturing production. On the other hand, employment, both in absolute numbers and as a proportion of total manufacturing employment, has been declining in the three sectors both in Canada and in the United States.

Table 2

**CANADA - UNITED STATES  
GROSS DOMESTIC PRODUCT OF  
TEXTILE INDUSTRIES  
IN CONSTANT DOLLARS**

(as a percentage of all manufacturing industries)

	CANADA				UNITED STATES		
	1970/72	1975/77	1980/82		1971/72	1975/77	1980/82
Textiles	3.5	3.3	3.3	)			
				)	3.4	2.9	3.0
Knitting	0.9	0.8	0.8	)			
Clothing (1)	3.2	3.1	2.8		3.3	3.4	3.4
Total - Textile Industries	7.6	7.2	6.9		6.7	6.3	6.4

(1) U.S. data includes "Miscellaneous Fabricated Textile Products".

SOURCE: Statistics Canada, Cat. 61-213, and Survey of Current Business (United States).

Table 3

**CANADA - UNITED STATES  
EMPLOYMENT IN TEXTILE INDUSTRIES**

(as a percentage of all manufacturing industries)

	CANADA			UNITED STATES		
	1970/72	1975/77	1980/82	1970/72	1975/77	1980/82
Textiles	4.4	3.9	3.6	4.6	4.4	3.8
Knitting	1.5	1.3	1.1	1.3	1.2	1.1
Clothing	6.0	5.7	5.2	6.3	5.9	5.3
Total - textile industries	11.9	10.9	9.9	12.2	11.5	10.2
Manufacturing industries as a percentage of total employment in the economy	24.3	21.5	20.1	24.9	22.0	20.5

SOURCE: Statistics Canada, Cat. 31.-203, and U.S. Department of Labour.

Although these are only general statistics, they seem to prove, as a general rule, that increasing penetration of imports and improvements in productivity are occurring at comparable rates in both countries and produce results similar in nature and importance.

Regional Structure of Textile Activities

Textile and clothing industries are often located within relatively restricted areas. The location of textile industries is a function of the availability of raw materials and favorable climatic and

environmental conditions (humidity levels, adequate water supply). Clothing industries are generally located near their major market. To an increasing extent, the availability and cost of labour are important considerations to both industries.

In Canada the textile and knitting industries are concentrated in certain specific areas of two provinces, Québec and Ontario. As shown in Table 4, these two provinces accounted for more than 90 per cent of all employment in the textile and knitting industries in 1972, 1977 and 1982. For the clothing industry, three provinces, the preceding two and Manitoba, accounted during the same period for more than 90 per cent of total employment, with Manitoba's share at 7 per cent.

In the United States, a country much more populous than Canada and made up of many more states of more even area than Canadian provinces, the geographic concentration of activity of the textile industries is less pronounced, but is nevertheless clearly noticeable. Ten American states - North and South Carolina, Georgia, Florida, Texas, California, New York, Massachusetts, New Jersey and Pennsylvania - account for more than 60 per cent of employment in textiles, knitting and clothing.

Three of the states (the two Carolinas and Georgia) account for 45 per cent of total employment in textiles and knitting, while four others (New York, Pennsylvania, California and Texas) provide 40 per cent of all employment in clothing. In the United States, there is therefore a strong concentration in textiles and knitting in three Southeastern states, and in clothing, in New York and Pennsylvania in the East, and in California and Texas in the Southwest.

Table 4

CANADA  
REGIONAL DISTRIBUTION OF TEXTILE EMPLOYMENT

(Number of employees and percentage)

	1972		1977		1982	
	Number	%	Number	%	Number	%
<u>Textiles</u>						
Newfoundland	x	x	x	x		
Nova Scotia	1,355	1.8	1,266	1.9		
Prince Edward Island	x	x	x	x		
New Brunswick	x	x	219	0.3		
Québec	38,783	52.2	31,805	48.6	27,721	46.7
Ontario	31,060	41.8	29,466	45.0	27,274	45.9
Manitoba	706	1.0	632	1.0	662	1.1
Saskatchewan	124	0.2	119	0.2		
Alberta	622	0.8	939	1.4		
British Columbia	1,183	1.6	984	1.5		
CANADA	74,242	100.0	65,508	100.0	59,416	100.0
<u>Knitting</u>						
Newfoundland	-	-	-	-		
Nova Scotia	1,304	5.3	x	x		
Prince Edward Island	-	-	-	-		
New Brunswick	x	x	x	x		
Québec	15,152	61.3	12,168	59.0	9,971	54.4
Ontario	7,400	29.9	6,686	32.4	6,927	37.8
Manitoba	334	1.4	427	2.1		
Saskatchewan	-	-	-	-		
Alberta	x	x	x	x		
British Columbia	x	x	x	x		
CANADA	24,732	100.0	20,628	100.0	18,318	100.0

Table 4 (cont'd)

CANADA  
REGIONAL DISTRIBUTION OF TEXTILE EMPLOYMENT

(Number of employees and percentage)

	1972		1977		1982	
	Number	%	Number	%	Number	%
<u>Clothing</u>						
Newfoundland	x	x	-	-		
Nova Scotia	129	0.1	145	0.3		
Prince Edward Island	-	-	-	-		
New Brunswick	x	x	x	x		
Québec	66,016	64.7	60,976	64.2	54,441	59.6
Ontario	23,298	22.8	22,710	23.9	23,722	26.0
Manitoba	7,361	7.2	5,577	5.9	6,468	7.1
Saskatchewan	447	0.4	602	0.6		
Alberta	x	x	x	x		
British Columbia	2,410	2.4	2,406	2.5		
CANADA	102,043	100.0	94,939	100.0	91,306	100.0

- : Nil Other data for 1982 is not available.

x : Confidential

SOURCE: Statistics Canada, Cat. 31-203.

Knowledge of these regional concentrations is of some importance in planning a free trade area because of transportation costs to and from these regional concentrations which will be analyzed later.

### Structure in Terms of Establishment Size

In 1977 there were 974 textile establishments and 1,975 establishments producing clothing in Canada. In the same year, the United States had 12,654 textile establishments and 20,976 clothing establishments, that is more than ten times the numbers in Canada. It is evident, therefore, that the predominance of small and medium-sized firms in textile industries is as pronounced in the United States as in Canada.

The most recent statistics available in the United States are those for 1977. Though more recent statistics for Canada are available, they are not directly comparable to those for 1977. As the size-structure of establishments varies only slowly, more up-to-date statistical information would change the overall picture very little.

In theory, it could be expected that a market eleven to twelve times larger than the Canadian market would correspond to an average size of establishments much larger than the one for Canadian establishments. The average size of establishments in the United States is effectively larger than in Canada, but the difference is rather small in many sectors. Also, there are sectors where Canada surpasses the United States (Table 5).

The average size of establishments is a rather crude measure since it does not contain any indication of frequency distribution by size category. To correct this omission Table 6 distributes establishments in six size categories. This table shows that with few exceptions the proportion of very small establishments of less than 20 employees is substantially larger in the United States than in Canada. It also shows that large establishments of more than 500 or 1000 employees are very rare in Canada while



they are more frequent in the United States and are primarily establishments producing cotton yarns and fabrics and man-made fibres, yarns and fabrics.

The conclusion to be drawn from Table 6 is that opportunities for significant economies of scale (increased production efficiency in proportion to the increasing number of units produced) in textile, knitting and clothing production do not apply to all products. There are no doubt some sectors making standardized products for which economies of scale are important, but there are evidently many others where it is only a secondary factor. In the United States, 75 per cent of the 183 establishments with more than 1000 employees produce textiles, and 25 per cent only produce clothing. In Canada, six of the seven establishments of more than 1000 employees are in textiles, and only one in clothing.

Textile and clothing production is nevertheless as fragmented in the United States as in Canada. In the textile industry, establishments with less than 50 employees account for 74 per cent of all establishments in the United States, and 70 per cent in Canada. In the clothing industry the proportion of establishments with less than 50 employees amounts to 70 per cent in the United States and 68 per cent in Canada. It can therefore be concluded that the proportion of establishments operating in limited regional markets is as high in one country as in the other.

Table 5

CANADA - UNITED STATES  
AVERAGE NUMBER OF EMPLOYEES PER ESTABLISHMENT  
IN THE TEXTILE AND CLOTHING INDUSTRIES

1977

Sectors	Total Number of Employees		Number of Production Employees	
	Canada	United States	Canada	United States
Textiles, total	79	83	63	71
Clothing, total	54	59	48	52
Wool yarns and fabrics	135	78	111	68
Cotton yarns and fabrics, man-made fibres, yarns and fabrics	231	325	178	285
Knitted fabrics	59	99	49	84
Dyeing and finishing	44	109	39	90
Carpets and rugs	229	94	159	75
Ladies' clothing	50	45	45	39
Men's clothing	74	123	66	109
Children's clothing	51	70	44	58
Fur goods	9	6	7	5
Hosiery	75	96	66	86
Knitted clothing	87	94	79	82

SOURCE: Statistics Canada, Census of Manufactures, and  
U.S. Bureau of Census, 1977 Census of Manufactures.

Table 6

**CANADA - UNITED STATES**  
**DISTRIBUTION OF TEXTILE AND CLOTHING ESTABLISHMENTS**  
**BY SIZE CATEGORIES**  
**1977**  
 In per cent

		Less than 20 employees	20-49	50-99	100-499	500-999	1000 employees and more
Textiles, total	Canada	48	22	10	17	2	1
	United States	59	15	8	14	3	1
Clothing, total	Canada	40	28	18	14	*	*
	United States	46	24	14	15	1	*
Wool yarns and fabrics	Canada	22	28	8	39	3	-
	United States	47	18	11	21	3	-
Cotton yarns and fabrics, man-made fibres, yarns and fabrics	Canada	14	14	15	48	7	2
	United States	24	9	9	38	13	7
Knitted fabrics	Canada	31	37	16	14	2	-
	United States	39	20	13	24	3	1
Dyeing and finishing	Canada	46	29	11	14	-	-
	United States	42	18	14	21	4	1
Carpets and rugs	Canada	10	20	10	53	7	-
	United States	52	14	12	18	3	1
Ladies' clothing	Canada	30	37	22	11	-	-
	United States	47	27	14	11	*	*
Men's clothing	Canada	33	27	17	21	1	1
	United States	31	16	16	35	1	1
Children's clothing	Canada	32	27	28	13	-	-
	United States	43	23	14	19	1	*
Fur goods	Canada	92	6	1	1	-	-
	United States	92	6	2	*	-	-
Hosiery	Canada	26	26	20	28	-	-
	United States	39	21	13	23	3	1
Knitted clothing	Canada	25	25	18	32	*	-
	United States	40	26	13	17	2	2

\* Negligible.

SOURCE: Statistics Canada, Census of Manufactures, and  
 U.S. Bureau of Census, Census of Manufactures.

## External Trade in Textile Products

When a comparison is made of the external trade in textile products of Canada with that of the United States, it becomes immediately apparent that Canada imports considerably more yarns and fabrics than the United States. As shown in Tables 7 and 8, the value of Canadian imports of these products is proportionately much more important than in the United States. Thus, in 1983 the value of yarn imports in the United States was only 21 per cent greater than the value of yarn imports in Canada (at the

**Table 7**

**CANADA  
IMPORTS AND EXPORTS OF  
TEXTILE AND CLOTHING PRODUCTS**

(In thousand Canadian dollars)

	1979	1980	1981	1982	1983
<u>Imports</u>					
Yarns	319,771	296,228	330,771	267,423	367,324
Fabrics	1,013,025	912,497	1,028,630	870,900	1,049,960
Clothing	828,507	804,861	976,636	1,002,047	1,233,488
<b>TOTAL</b>	<b>2,161,303</b>	<b>2,013,586</b>	<b>2,336,037</b>	<b>2,140,370</b>	<b>2,650,772</b>
<u>Exports</u>					
Yarns	36,668	58,848	82,848	58,215	72,109
Fabrics	128,859	161,096	167,036	158,960	132,621
Clothing	180,236	220,421	233,278	210,325	200,210
<b>TOTAL</b>	<b>345,763</b>	<b>440,365</b>	<b>483,162</b>	<b>427,500</b>	<b>404,940</b>

SOURCE: Statistics Canada, Cats. 65-004, 65-007.

Table 8

UNITED STATES  
IMPORTS AND EXPORTS OF  
TEXTILE AND CLOTHING PRODUCTS

(In thousand U.S. dollars)

	1979	1980	1981	1982	1983
<u>Imports</u>					
Yarns	173,958	196,794	230,900	260,149	355,360
Fabrics	1,484,585	1,632,563	2,016,647	1,776,435	1,982,676
Clothing	5,812,912	6,376,291	7,479,211	8,164,569	9,582,982
TOTAL	7,471,455	8,205,648	9,726,758	10,201,153	11,921,018
<u>Exports</u>					
Yarns	620,696	752,980	902,090	710,859	533,219
Fabrics	1,980,759	2,176,717	1,987,942	1,489,431	1,306,118
Clothing	931,173	1,202,506	1,232,143	952,318	817,547
TOTAL	3,532,628	4,132,203	4,122,175	3,152,608	2,656,884

SOURCE: U.S. Department of Commerce (FT. 135 and FT. 410).

exchange rate of Canadian \$1 = U.S. \$0.80) while the total market in the United States is at least ten times greater than in Canada. The value of fabric imports in the United States was only 2.4 times greater than in Canada. The situation is better balanced in clothing: in 1983, Canadian imports amounted to \$1.2 billion and United States imports (in Canadian dollars) close to \$12 billion.

Canada therefore imports many textile products on a continuous basis because its textile industry does not produce the complete range required. With a much larger market the United States appear to satisfy their own needs more completely, and their yarn and fabric imports are relatively limited. Conversely, both countries are in a similar situation with regard to clothing.

Data on exports confirm the preceding conclusion. In 1983, the United States exported 9.2 times as much yarn and 12.3 times as much fabric as Canada did. However, their exports of clothing were only 5.1 times those of Canada. Canadian efforts to export clothing are proportionately greater than the United States efforts, even if the result for Canada must be attributed in part to fur clothing.

Even with these exports, the two countries are not major exporters of textile products. Both have large trade deficits in textiles and clothing: in 1983 the Canadian trade deficit in these products amounted to \$2.2 billion while the deficit in the United States (in Canadian dollars) was \$11.6 billion. However, in Canada the deficit was split almost evenly between textile and clothing products while in the United States the deficit in textile products was only 5 per cent of the total, and the deficit in clothing, 95 per cent.

As to bilateral exchanges in textile and clothing products between Canada and the United States, data available indicate that Canada obtains close to 60 per cent of its total imports of fibres, yarns and fabrics from the United States, and these account for one quarter to one third of



United States exports. The situation is very different for clothing: only slightly more than one tenth of all clothing imports in Canada originates in the United States, and only slightly more than one tenth of total clothing exports of the United States are destined for Canada.

Canadian exports of textiles and clothing are being directed more and more to the United States. As recently as three years ago, one third of textile exports and less than half the clothing exports were going to the United States. In 1983, exports to the United States accounted for practically half of all textile exports and more than two thirds of total exports of clothing.

Thus, even at present and with no significant tariff advantage, Canada and the United States are already conducting relatively extensive trade in textile and clothing products. The United States is the largest source of Canadian imports of textiles and clothing and the main destination of Canadian exports of these products. However, for the United States, Canada is only a minor source of imports, barely 2 to 2.5 per cent of total imports, but it is a more significant destination for exports (between 20 and 30 per cent).

Since statistics on external trade do not provide any information on the characteristics or the quality of the products traded, it is not known if trade in textile and clothing products between Canada and the United States consists of trade in general or specialized products. However, a qualitative assessment can be made to a certain extent and in a rather approximate manner by examining the unit values of products imported from the United States and exported to that country by Canada.

Since import and export statistics for Canada are not recorded in corresponding categories, the Board has had to do some rearrangement of these statistics. An adequate concordance has thus been achieved for 28 categories of textile products and 18 of clothing products. For each category, the quantities and values imported and exported have been calculated for the years 1972, 1976, 1979, 1980, 1981 and 1982.

For each category the unit values of imported and exported products show surprising coherence. For 24 of the 28 textile categories, the unit values of products imported into Canada are clearly higher than the unit values of the same types of products exported to the United States, while the reverse is true for only one category. The comparison could not be made for the three remaining categories because only the values of exports to the United States were available while statistics on quantities could not be obtained.

Conversely, the unit values of products exported to the United States were clearly higher than the unit values of products of the same category imported into Canada for 15 of the 18 categories of clothing, while the opposite applied for two other clothing categories. With regard to the remaining category, that of fur clothing, the comparison could not be made since statistics on quantities could not be obtained.

Thus, Canada imports textile products from the United States with unit values substantially and systematically higher than the unit values of its exports to that country. While Canadian producers can make basic products in sufficient volumes to make it economically worthwhile, the more specialized products are often imported from the United States, where

the domestic market is large enough to allow production on a sufficiently large scale. In contrast, Canadian textile exports to the United States are confined to basic products, along with very few specialized products.

For clothing, the exact opposite applies. Canada exports products with a high unit value to the United States while it imports from the latter large quantities of basic apparel at relatively low unit values. Even with relatively high tariff protection in the United States the Canadian producers of high quality clothing manage to find outlets in the United States, although their share of this market is still very small. In contrast, the United States producers have an advantage over Canadian producers with regard to standard clothing items: their long production runs allow them to produce at very low costs.

Even if these general findings appear to be fully justified by statistical analysis, some caution must still be exercised in interpreting them. In effect, certain products, particularly ladies' apparel, are inadequately covered by our 46 categories of products. Moreover, even if there was perfect coverage of all products by our 46 categories there would still be exceptions to our general findings, since there are Canadian textile producers exporting products of high unit value as well as Canadian clothing manufacturers who manage to export relatively cheap clothing. The results obtained for the 46 product categories indicate a general trend toward specialization, but do not exclude possible exceptions.

With regard to trade in textile and clothing products with low-cost countries, both Canada and the United States make use of restraint measures with rather similar results: a comparison of the value of per capita imports in both countries reveals that overall, the respective values of textile and clothing imports from low-cost countries are at very close levels to each other (Table 9).

Table 9

CANADA - UNITED STATES  
VALUE OF TEXTILE IMPORTS FROM  
LOW-COST COUNTRIES

(In U.S. dollars per capita)

	1978	1979	1980	1981	1982
Textile products					
Canada	7.25	9.47	9.23	10.80	8.74
United States	4.12	4.24	4.91	6.06	5.31
Clothing products					
Canada	16.25	20.40	20.00	24.85	24.86
United States	22.65	23.05	25.73	30.17	32.63
Total					
Canada	23.50	29.87	29.23	35.65	33.60
United States	26.77	27.29	30.64	36.22	37.94

SOURCE: Textile and Clothing Board, based on data from "U.N. Trade Statistics"  
(International Trade Data Bank).

During the last five years for which statistical data are available, the value of American per capita imports was 4.6 per cent higher than the value for Canada. However in terms of value, the United States import 46 per cent less textiles and 26 per cent more clothing than Canada, which supports the earlier finding that the United States textile industry is more diversified than Canada's.

These statistics are counter to the belief, very popular in Canada, that the import restraint system applied by the United States is much more restrictive than the Canadian system.

### Tariff Protection

An assessment cannot be made of the potential impact on participating countries of a sectoral free trade area unless it is known how much protection the products of the sector in question already enjoy.

There is a major difference in tariff protection in Canada and in the United States with regard to the number of tariff items for textiles and clothing. The Canadian customs tariff contains only 300 tariff items for these products; for the United States the number of items is about ten times larger.

A customs tariff as detailed as this allows a refined modulation of tariff items as required. Furthermore, such a detailed customs tariff prolongs the time required for customs valuation and increases administrative discretion, the unpredictability of valuation results, and the number of potential litigations. Since the Canadian customs tariff is simpler and more transparent than the United States customs tariff, the elimination of tariffs would considerably reduce the administrative uncertainties experienced by Canadian exporters, while not changing much the conditions of operation of Canadian importers. This would be advantageous for Canadian manufacturers.

Administrative complexities of the customs tariff constitute one problem, and the relative level of tariff applied constitutes another. In general, the United States applies relatively low tariffs to primary cotton products, but tariffs are higher for wool and man-made fibre products (Tables 10 and 11). It is mainly wool fabrics which are subjected to high customs duties, while in Canada there is a relatively low maximum for these duties.

Table 10

CANADA - UNITED STATES  
COMPARISON OF TARIFFS FOR YARNS

	Canada	United States	
		Gelge	Dyed
100 % Cotton yarns			
- for knitted outerwear, carded 18's	15%	5.7%	8.4%
- for knitted underwear and knitted velours, carded 24's	15%	5.9%	8.6%
- for fine outerwear, combed 30's	15%	6.5%	9.2%
- for interlock knitting, combed 38's	15%	7.3%	10.0%
Polyester-cotton yarns(1)	10% + 7.5¢/lb.	12.7%	15.4%
Wool yarns (wholly or in part)	11.2% + 5¢/lb.	13.5%	13.5%
Man-made yarns(2)	10% + 7.5¢/lb.	13%	13%

- (1) The United States tariff is based on prime value. If the value of the polyester in a yarn is greater than the value of the cotton, the applicable tariff rate is the one for man-made yarns. In Canada, yarns containing more than 5 per cent man-made fibres are subject to the rate for man-made yarns.
- (2) Single yarns with less than 20 turns per inch and valued at more than \$1.00 per pound.

SOURCE: Textile and Clothing Board.



Table 11

CANADA - UNITED STATES  
COMPARISON OF TARIFFS  
FOR WOVEN PRODUCTS

	Canada		United States	
	Greige	Dyed	Greige	Dyed
100% Cotton fabrics				
Print cloth	16.3%	18.8%	11.9%	16.2%
Broadcloth	16.3%	18.8%	12.2%	16.5%
Sheeting	16.3%	18.8%	8.1%	12.4%
Drill	16.3%	18.8%	7.1%	11.4%
Denim 10 ounces	16.3%	18.8%	7.4%	11.7%
12.25 ounces	16.3%	18.8%	7.1%	11.4%
14.50 ounces	16.3%	18.8%	6.8%	11.1%
Corduroy	16.3%	18.8%	-	30.5%
Polyester-cotton (65/35) fabrics	25% + 7.5¢/lb.		13%	
Woolen and worsted fabrics				
Valued over \$2.00 but not over \$9.00 per pound	25% + 12.5¢/lb. (max. \$1.10/lb.)		38% + 30¢/lb.	
Valued over \$9.00 per pound	25% + 12.5¢/lb. (max. \$1.10/lb.)		35.5% + 19¢/lb.	
Man-made fibre fabrics	25% + 7.5¢/lb.		19% + 6¢/lb.	
			Ornamented	Non- ornamented
Sheets and pillowcases	Cotton, 22.5% ) Polyester/cotton 25% )		28.9%	8.6%
Towels (cotton)	22.5%		22.6%	12.8%

SOURCE: Textile and Clothing Board.

Since the relative structure of customs tariffs is a reflexion of competitive ability, it must be deduced that the Canadian cotton and polyester/cotton industry would experience some difficulty in a potential free trade area with the United States. This could also be the case, but to a lesser extent, for the man-made yarn and fabric industry. In contrast, the Canadian wool industry, whose level of protection is very small compared to that in the United States, could become one of the major winners in a free trade area.

Tariff protection for clothing in Canada varies within very narrow limits, that is between 22.5 and 26.3 per cent of its value. Conversely, in the United States the spread of customs tariffs applicable to clothing is much wider, ranging from 8.0 to 38.8 per cent. While there is very little discrimination in the Canadian tariff system, the United States tariff discriminates significantly between ornamented and non ornamented clothing, and between clothing made of knit or woven fabrics and clothing made of man-made or wool fabrics (Table 12). In general, the highest levels of customs duties apply to knitted garments with a high fashion and ornamental content and made of yarns other than cotton.

The low degree of discrimination of Canadian tariffs leads to the belief that in the event of a free market, the Canadian clothing industry would be more or less uniformly exposed to competition with the U.S. clothing industry. In contrast, since U.S. tariffs are highly discriminatory, the major beneficiaries of the elimination of these tariffs would be those Canadian producers specialized in the production of high quality, high fashion garments, either knitted or made of woven man-made or wool fabrics.

Table 12

CANADA - UNITED STATES  
COMPARISON OF TARIFFS  
FOR CLOTHING

Products	Canada	United States	
		Non ornamented	Ornamented
Men's and Boys' Apparel			
<u>Cotton</u>			
Knit			
Coats, suits, trousers, slacks, athletic suits	26.3%	18.8%	28.0%
shirts, sweaters	26.3%	21.0%	28.0%
Pyjamas, bathrobes	26.3%	14.5%	26.0%
Not knit			
Coats (valued over \$4.00 each)	22.5%	8.0%	28.0%
Pyjamas (valued over \$1.50 each)	22.5%	8.0%	26.0%
Shirts	22.5%	21.0%	28.0%
Trousers	22.5%	16.5%	28.0%
<u>Wool</u>			
Knit			
Sweaters (not over \$5.00/lb.)	26.3%	25.1% + 23¢/lb.	34.0%
Coats, suits, slacks (over \$5.00/lb.)	26.3%	20% + 36.3¢/lb.	34.1%
Other garments (over \$5.00/lb.)	26.3%	18.5% + 19¢/lb.	34.0%
Not knit			
Coats, suits, shirts, trousers, slacks, shorts (over \$4.00/lb.)	25.0%	21% + 31¢/lb.	34.1%
Dressing gowns, bathrobes (over \$4.00/lb.)	25.0%	19% + 19¢/lb.	34.0%
<u>Man-made</u>			
Knit			
Coats, suits, trousers, shorts	26.3%	31.3% + 12¢/lb.	36.3%
Shirts, sweaters	26.3%	32.5% + 19¢/lb.	38.8%
Swimwear	26.3%	28.8% + 12¢/lb.	36.3%
Pyjamas	26.3%	25.9% + 14¢/lb.	34.0%
Not Knit			
Coats, suits, trousers, shorts shirts, swimwear	25.0%	27.5% + 19¢/lb.	36.3%

SOURCE: Textile and Clothing Board.

Table 12 (cont'd)

CANADA - UNITED STATES  
COMPARISON OF TARIFFS  
FOR CLOTHING

Products	Canada	United States	
		Non ornamented	Ornamented
Ladies', Girls', Children's Apparel			
<u>Cotton</u>			
Knit			
Blouses, shirts, sweaters	26.3%	21.0%	28.0%
Coats, suits, slacks	26.3%	18.8%	28.0%
Dresses	26.3%	16.5%	26.0%
Other	26.3%	14.5%	26.0%
Not Knit			
Blouses, shirts	22.5%	16.5%	25.8%
Suits, slacks	22.5%	16.5%	28.0%
Coats (valued over \$4.00 each)	22.5%	8.0%	25.8%
Dresses	22.5%	14.3%	26.0%
Other	22.5%	12.3%	26.0%
<u>Wool</u>			
Knit			
Coats (over \$5.00/lb.)	26.3%	20% + 34¢/lb.	34.1%
Blouses, dresses, skirts, sweaters (over \$5.00/lb.)	26.3%	18.5% + 19¢/lb.	34.0%
Not Knit			
Blouses, shirts (over \$4.00/lb.)	25.0%	21% + 37.5¢/lb.	34.1%
Coats (over \$4.00/lb.)	25.0%	21% + 29¢/lb.	34.1%
Dresses, slacks, suits, nightgowns (over \$4.00/lb.)	25.0%	19% + 19¢/lb.	34.0%
<u>Man-made</u>			
Knit			
Blouses, shirts, sweaters, T-shirts	26.3%	32.5% + 19¢/lb.	38.8%
Coats, suits, trousers, shorts	26.3%	31.3% + 12¢/lb.	36.3%
Swimwear (over \$10.00 each)	26.3%	24.8% + 12¢/lb.	36.3%
Dresses, coveralls	26.3%	25.9% + 14¢/lb.	34.0%
Not Knit			
Blouses, coats, shirts, suits, trousers	25.0%	27.5% + 21¢/lb.	36.3%
Other	25.0%	22.3% + 12¢/lb.	34.0%

SOURCE: Textile and Clothing Board.

Thus, a comparison of U.S. and Canadian customs tariffs suggests that there would be possibilities of specialization in an eventual free market. However, it should be noted that competitive ability is determined not only by the relative level of protection but also by numerous other factors such as design, marketing techniques, etc.

#### Non-Tariff Protection

Non-tariff protection can distort the conditions of competition between two countries just as much as tariff protection. At times non-tariff protection can be even more harmful than tariff protection since it is less evident and could simply block any possibility of trade between two countries.

Non-tariff measures of protection which could affect Canadian exports of textiles and clothing to the United States are not very numerous.

First, labelling regulations in the United States are different and could impose additional, although minimal, costs to Canadian exporters. Conversely, the same situation evidently applies to U.S. exporters. Second, flammability regulations for children's clothing are also different. In this respect the adjustment would be more onerous for Canadian producers who would have to abide by the U.S. regulations which are more restrictive than Canadian regulations. However, neither set of regulations would give rise to insurmountable difficulties.

Other regulations, however, could have more restrictive effects in a potential free trade area. These are mainly the regulations concerning government procurement, where preferences are given to domestic producers.

The "Buy American Act" of 1933 stipulates that a preference of 6 per cent must be accorded to domestic suppliers by federal agencies, and that this preference can go up to 12 per cent where tenders are submitted by small firms, firms belonging to minority groups, or firms located in regions of high unemployment. Legislation approved in 1978 reserves for such firms from 5 to 15 per cent of government purchases for which tenders are called. This so-called "set aside" policy is reinforced by the stipulation that when a product has been purchased by the "set aside" system, future purchases will have to be by the same system as long as there are at least two tenderers answering each subsequent call for tenders.

The Department of Defense of the United States has its own regulations. The most important of these, the "Berry Amendment" prohibits the army from acquiring textile and clothing products not made in the United States.

In addition to the various federal departments and agencies, at least 34 state or local governments in the United States apply preferential purchasing policies.

It should also be noted that the existence of a very large number of tariff items allows the U.S. customs administration to have major discretionary powers. It is this customs administration which, in fact, must classify each product to a specific tariff item. This classification often involves decisions with a certain arbitrary content which could adversely affect U.S. importers and Canadian exporters and lead to lengthy and costly litigation.

This problem would evidently disappear if a free trade area were to be established. It could nevertheless still be present throughout the whole transition period during which successive reductions in tariff rates would lead to the establishment of a free trade area.

Canadian producers also have some misgivings concerning "DISC" (Domestic International Sales Corporation) and anti-dumping legislation.

The "DISC" gives United States manufacturers an advantageous tax treatment on profits from exports. Only a portion of these profits is taxable as income if they are deposited in a special fiscal institution, the "DISC" of the companies. From 1972 to 1976, only half of the profits deposited in the "DISC" was deemed to have been distributed to the shareholders and income tax was paid only on that half. The other half could remain indefinitely with the "DISC" without shareholders having to pay tax on it. Since 1976 the rules have been changed and income tax must be paid on 70 per cent of the amounts deposited, the other 30 per cent remaining exempt. This fiscal advantage accorded to profits from exports can be enhanced by making use of special regulations regarding transfer prices allowed between the manufacturing company and its "DISC".

The "DISC" legislation manifestly constitutes an export subsidy which can result in unequal conditions of competition between Canadian and U.S. producers. In a free trade area such favourable treatment has no place and "DISC" would not apply to trade between Canada and the United States if textile and clothing products are to be freely exchanged.

Anti-dumping legislation in the United States also worries Canadian producers. They fear that, in the event they are successful in the United States markets, the U.S. producers, in an attempt to reduce Canadian producers' competitive edge and their penetration of U.S. markets, would allege that Canadian producers are resorting to dumping practices. Such an eventuality, even if very unlikely, must not be dismissed in advance. In another respect, in a free trade area, dumping practices must be rigidly regulated, and any free trade agreement in one or several industrial sectors will have to contain regulations to this effect.

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In view of the structural characteristics of textile and clothing industries in Canada and the United States the conclusion can be made that these two industries play relatively similar roles in both countries. Their contribution to gross domestic product and to manufacturing employment is of the same order of magnitude. In both countries the textile industry tends to locate itself away from large industrial centres or large consuming centres in order to take advantage of local raw material availability, or a relatively abundant labour force, or again favorable regional conditions. These favorable regional conditions can include numerous factors such as a low level of local taxation, incentives for the establishment of new plants and for investment, assistance for manpower



training, low level of unionization, availability of water supplies, etc. In contrast, the clothing industry tends to be concentrated near large consuming centres, even if satellite sewing plants are located in less populous centres.

In both countries, textile and clothing firms are typically small or medium size firms. Relatively large firms dominate only a very small number of sub-sectors in primary textiles, particularly in the production of man-made fibres, cotton and man-made yarns and cotton and man-made fabrics.

However, Canada is a more open country than the United States in terms of openness of its national market, mainly because it does not and has never produced the full range of textile products. Indeed, the relatively limited dimension of its domestic market has imposed some specializations on Canada and has left the door open to the importation of other products which could not have been produced domestically under favourable economic conditions. In contrast, in the United States the size of the market has always been sufficient to justify the manufacture of a relatively complete range of primary textile products.

The two countries import considerable quantities of clothing, particularly high fashion, high quality apparel, and standard items of clothing which low-cost countries manage to produce more economically. Within proportion, imported clothing has, in terms of volume, the same relative importance in both countries.

There are, however, major differences between the tariff protection systems applied by Canada and the United States. The Canadian system is relatively simple and transparent, while the United States' system is complex because it tries to protect specific market segments. Tariff

protection in the United States discriminates between products according to major fibre component and degree of finish, while Canadian tariff protection does not do this. In addition, the existence of 3,000 tariff items gives considerable discretionary powers in U.S. customs administration.

With regard to special measures of protection, - i.e., restraints negotiated with low-cost exporting countries - their overall results appear to be fairly comparable in Canada and the United States. The per capita value of imports from low-cost countries is, in effect, very similar for both countries.

### 3. COMPETITIVE ABILITY OF CANADIAN TEXTILE AND CLOTHING INDUSTRIES

The competitive ability of any industry is determined by two basic factors: cost of the various inputs and productivity, that is the efficiency with which these inputs are combined to obtain a given product.

The major costs in manufacturing production are labour costs, raw material costs and capital costs. Labour cost is further subdivided into costs of labour directly engaged in production (wages and fringe benefits), and in indirect labour costs (warehousing personnel, research staff, sales and general administrative personnel). Raw material costs include the cost of raw materials as such, and the cost of other supplies required for production: in the case of textiles, these consist of the various chemical compounds used in fibre preparation and finishing, dye-stuffs, energy, water, etc; for clothing, they consist of the variety of findings required. Finally, capital costs include depreciation costs of fixed assets (buildings and equipment) and financial costs.

For a certain number of products of the textile and clothing industries, it is impossible, for all practical purposes, to obtain valid data on specific unit costs and on productivity of inputs per unit of product. Nevertheless, it is possible to determine the cost structure of certain products.

Statistical information on cost structure in the textile and clothing industries in Canada and the United States has been developed by the consulting firm of Kurt Salmon Associates-Canada Limited in

collaboration with Kurt Salmon Associates Inc. of the United States. To ensure comparability of the results the survey for the year 1983 was limited to ten textile products and fifteen clothing items.

The results obtained are not presented in terms of overall averages for all the firms. Rather, the costs have been collected for two groups of firms, identified as "best" firms and "typical" firms. The "best" firms are those which already utilize the best performing machinery available on the market. "Typical" firms are those which use average technology found in firms which are not in the forefront of progress, but still not obsolete or outmoded.

It has thus been possible to compare for each category of products the production cost structures of "best" firms and of "typical" firms in both Canada and the United States. Marginal firms whose equipment is considered obsolete or outmoded were excluded from the survey in both countries.

There is one limitation to the survey which must be pointed out: because of the widely differing situations of individual firms the survey did not attempt to cover depreciation costs of fixed assets, nor financial costs. The survey therefore contains no information on capital costs or financial results.

However, this limitation, which at first glance appears to be a major one, is not a critical one. In fact, prices are relatively similar for the various pieces of equipment which are often imported in both countries from identical sources. As to building costs, they will be considered later when examining overall construction costs of industrial

buildings in both countries. Finally, as for financial costs, it is well known that these costs are greater in Canada than in the United States, although this difference does not represent a significant competitive disadvantage.

#### Summary of Results of the Survey on Costs

All data on the results of the survey on costs have been calculated on the basis of the exchange rate prevailing in the last months of 1983: Canadian \$1 = U.S. \$0.80 or conversely, U.S. \$1 = Canadian \$1.25. At this rate of exchange the survey results show that production costs in the textile and clothing industries are generally higher in Canada than in the United States.

#### Textile Industry

Total cost per unit of product is given in Table 13 for each of the ten textile products. This cost is higher in Canada in all cases. For the "best" Canadian firms, and depending on the product, this cost is 4 - 15 per cent higher than for the "best" U.S. firms. Furthermore, in eight out of ten cases, the cost of "best" Canadian firms is higher than the cost of "typical" U.S. firms.

It can also be seen from Table 13 that "typical" Canadian firms have total costs exceeding by some 10 per cent the total costs of "typical" U.S. firms (except in the case of two products where they are double or more), and those of "best" U.S. firms by about 20 per cent. It should also be noted that, overall, the disadvantage in Canadian costs is least

Table 13

**CANADA - UNITED STATES  
PRODUCTION COSTS AND INDICES OF PRODUCTION COSTS  
FOR TEN SELECTED TEXTILE PRODUCTS (1)**

(In Canadian dollars; cost of best American firms = 1.000)

	Canadian dollars				Indices			
	Cost in Canada		Cost in United States		Cost in Canada		Cost in United States	
	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms
Cotton yarn, carded 201, per lb.	2.042	2.259	1.928	2.088	1.059	1.172	1.000	1.083
Worsted spun acrylic yarn, 1/24, per lb.	2.622	2.744	2.300	2.369	1.140	1.193	1.000	1.030
Textured polyester yarn, 2/150 denier, per lb.	1.626	1.778	1.428	1.496	1.138	1.245	1.000	1.048
Woven greige print cloth, cotton; 48 inches per yard	0.670	0.733	0.616	0.665	1.088	1.190	1.000	1.080
Denim fabric; 12-3/4 ounces, 60 inches, per yard	3.364	3.660	3.253	3.458	1.034	1.125	1.000	1.063
Terry towel, institutional, per dozen	25.13	27.52	23.26	24.84	1.080	1.183	1.000	1.068
Bed sheet, double, flat; muslin, per unit	5.32	5.87	5.02	5.23	1.060	1.169	1.000	1.042
Textured woven polyester gabardine 60 inch; finished, per yard	1.997	2.338	1.743	1.905	1.146	1.341	1.000	1.093
Tufted carpet, typical mid-price; per square yard	8.643	9.117	7.903	8.358	1.094	1.154	1.000	1.058
Ladies' pantyhose, per dozen	13.76	14.87	12.41	13.49	1.109	1.198	1.000	1.087

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(1): Excludes depreciation costs of fixed assets and financial costs.  
SOURCE: Report by Kurt Salmon Associates-Canada Ltd.

pronounced for cotton products. Also, the products considered do not include any wool products for which the cost disadvantage, if any, is undoubtedly the least.

However, a breakdown of total costs for textile products reveals consistent differences between Canadian and U.S. industries (See Table 14).

For a great majority of the textile products covered in the survey, costs of direct wages and social charges, one of the two most important categories of costs, account for a greater share of total costs in Canada than in the United States, while raw materials and supplies, the other most important category, account for a smaller share. However, the wages paid in the textile industry in Canada are no higher than in the United States, while the cost of raw material is often higher. Thus, the difference in the share of total cost represented by wages is not due to differences in unit labour cost but rather to the degree of efficiency with which labour and raw materials are utilized. Since Canadian firms operate within a much more limited market than in the United States, the production runs are shorter and the number of runs higher. Production in a Canadian textile firm will be less specialized and the economies of scale smaller than in a U.S. firm.

For the same reasons - the relative absence of specialization and of economies of scale - manufacturing costs and selling and general administrative expenses are, with few exceptions, clearly higher in Canada than in the United States.

Table 14

**CANADA - UNITED STATES  
COST STRUCTURE FOR TEN SELECTED TEXTILE PRODUCTS (1)**

(In per cent of total cost)

Products	Direct labour and fringe benefits				Manufacturing overhead				Raw materials and supplies				Utilities				Selling, general and administrative expenses			
	Canada		United States		Canada		United States		Canada		United States		Canada		United States		Canada		United States	
	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal	Best	Typi- cal
Cotton yarn, carded 201, per lb.	18.2	21.7	17.1	19.9	12.2	12.4	11.3	11.3	56.5	52.6	58.0	54.7	4.7	4.7	6.2	6.4	8.4	8.6	7.4	7.8
Worsted spun acrylic yarn, 1/24, per lb.	25.8	27.4	23.3	24.0	10.9	10.3	10.4	10.6	50.3	48.4	52.8	51.2	3.6	3.6	5.0	5.3	9.3	10.2	8.7	9.0
Textured polyester yarn, 2/150 denier, per lb.	8.2	11.9	8.4	9.9	8.9	10.0	7.5	7.9	73.8	68.1	75.3	71.8	1.4	1.6	2.0	2.3	7.7	8.4	7.0	8.0
Woven greige print cloth, cotton, 48 inches, per yard	25.1	27.0	20.9	25.9	20.9	17.6	22.9	16.2	41.2	41.1	42.4	42.1	4.3	5.2	6.1	7.9	8.5	9.1	7.7	7.9
Denim fabric, 12-3/4 ounce, 60 inches, per yard	16.2	17.2	15.4	16.3	10.2	11.2	9.7	10.6	58.8	56.1	58.8	56.6	5.6	5.6	7.7	7.6	9.2	10.0	8.5	9.0
Terry towel, institutional, per doz.	27.9	29.2	26.2	27.7	13.6	12.4	13.3	11.7	37.7	36.8	39.1	38.5	4.9	5.3	6.7	7.0	15.8	16.4	14.7	15.1
Bed sheet, double/flat, muslin/unit	23.3	26.2	22.1	23.9	18.6	18.1	16.9	15.8	38.9	36.8	39.6	38.8	6.2	5.5	8.7	7.7	13.0	13.6	12.7	13.9
Textured woven polyester gabardine, 60 inch, finished, per yard	13.8	14.5	12.1	14.8	10.5	12.8	10.0	9.8	61.6	56.9	62.1	59.0	4.0	4.7	7.2	7.2	10.0	11.1	8.6	9.2
Tufted carpet, typical mid-price/per square yard	4.3	4.5	3.8	4.1	5.8	4.9	5.7	4.8	76.0	75.7	75.9	76.6	1.6	1.9	2.2	2.2	12.3	13.0	12.4	12.3
Ladies' pantyhose, per dozen	29.7	30.5	30.2	32.4	5.5	6.7	5.6	6.1	53.1	50.9	53.6	50.9	1.2	1.2	1.5	1.5	10.7	10.7	9.1	9.1

(1): Excludes depreciation costs of fixed assets and financial costs.

SOURCE: Report by Kurt Salmon Associates-Canada Ltd.



In contrast, Canadian textile firms benefit from advantageous costs for utilities (energy and water). For all the products examined the share of total costs held by the costs of these factors is less in Canada than in the United States. However, it must be mentioned that this difference rarely amounts to more than two per cent.

### Clothing Industry

In the clothing industry (see Table 15) a comparison of total costs of production between Canada and the United States shows that the cost advantages and disadvantages are less unevenly distributed than in the case of textile products, when in all cases the "best" Canadian firms had higher costs than the "best" U.S. firms, and more often than not higher costs than "typical" U.S. firms. In clothing, the "best" Canadian firms have a cost advantage over the "best" U.S. firms for five of the fifteen clothing items, and over "typical" U.S. firms for nine of the fifteen items, while for two others, the costs are practically identical, the difference amounting to less than one per cent.

With regard to "typical" Canadian clothing firms, their costs exceed those of "typical" American firms by some 7 per cent, while in relation to "best" U.S. firms they are higher by some 20 per cent.

The cost disadvantage of Canadian clothing producers is particularly pronounced for relatively standard products where economies of scale are significant: this is the case specifically for jeans, men's knit shirts, ladies' T-shirts and children's pyjamas. Conversely, Canadian clothing producers appear to be in a better competitive position in products with a higher fashion content, that is, ladies' sweaters, sportswear, men's suits, ladies' blouses and dresses.

Table 15

**CANADA - UNITED STATES**  
**PRODUCTION COSTS AND INDICES OF PRODUCTION COSTS**  
**FOR FIFTEEN SELECTED CLOTHING ITEMS (1)**

(In Canadian dollars per dozen; costs of best American firms = 1.000)

Clothing Items	Canadian Dollars				Indices			
	Cost In Canada		Cost In the United States		Cost In Canada		Cost In the United States	
	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms
Women's sweaters, 100% acrylic	96.19	111.37	99.33	110.70	0.968	1.121	1.000	1.114
Jogging suits, 100% acrylic	426.39	528.84	438.08	519.49	0.973	1.207	1.000	1.186
Men's suits, grade 2, 65% wool 35% polyester	1,231.54	1,364.94	1,259.26	1,362.70	0.978	1.084	1.000	1.082
Women's blouses, 100% polyester	119.25	143.31	120.91	140.80	0.986	1.185	1.000	1.165
Women's dresses, 65% polyester, 35% cotton	195.17	233.74	195.89	228.16	0.996	1.193	1.000	1.165
Women's reversible jackets 65% polyester, 35% cotton/ 100% nylon	670.55	795.91	648.60	755.50	1.034	1.227	1.000	1.165
Men's dress slacks 100% cotton	178.43	204.97	166.23	185.63	1.073	1.233	1.000	1.117
Brassieres, 90% polyester, 10% spandex	47.05	57.44	43.66	46.70	1.077	1.316	1.000	1.070
Women's skirts, 65% polyester, 35% cotton	119.76	139.47	110.08	124.35	1.088	1.267	1.000	1.130

Table 15 (cont'd)

**CANADA - UNITED STATES  
PRODUCTION COSTS AND INDICES OF PRODUCTION COSTS  
FOR FIFTEEN SELECTED CLOTHING ITEMS (1)**

(In Canadian dollars per dozen; costs of best American firms = 1.000)

Clothing Items	Canadian Dollars				Indices			
	Cost in Canada		Cost in the United States		Cost in Canada		Cost in the United States	
	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms
Men's briefs, 100% cotton	15.95	16.88	14.56	15.14	1.095	1.159	1.000	1.040
Men's dress shirts, 65% polyester, 35% cotton	98.67	107.72	89.71	97.70	1.096	1.201	1.000	1.089
Children's pyjamas, 50% cotton 50% polyester	68.60	78.02	60.85	79.19	1.127	1.282	1.000	1.301
Women's T-shirts, knit, 45% polyester, 55% cotton	31.16	34.93	27.56	30.44	1.130	1.267	1.000	1.104
Men's knit shirts, 50% polyester, 50% cotton	90.70	99.52	79.98	87.15	1.134	1.244	1.000	1.090
Men's jeans, 100% cotton	151.30	160.07	133.01	139.41	1.138	1.203	1.000	1.048

(1): Excludes depreciation costs of fixed assets and financial costs.

SOURCE: Report by Kurt Salmon Associates-Canada Ltd.

Supposing, and this seems reasonable, that all fabrics and other findings required for the manufacture of clothing which are utilized in Canada are presently sold at prices marked up by the full amount of customs duties, the elimination of such duties in a potential free trade area would provide a measure of the change in competitive ability of the Canadian industry following the establishment of a free trade area.

This change has been measured for the fifteen categories of clothing while taking into account the costs of fabrics and other findings in the total costs, and the specific duty rates applicable at present to these fabrics and findings (see Table 16).

The results show that the decrease in costs resulting from the elimination of customs duties would be relatively small in Canada. The "best" Canadian firms would have a possible cost advantage in six categories out of fifteen, instead of five, over the "best" U.S. firms. Against "typical" U.S. firms the "best" Canadian firms would have an advantage in thirteen categories instead of the eleven mentioned previously (advantage in nine and equality in two).

With the present duty rates, "typical" Canadian firms have the advantage in only one category. With these duties removed, they would acquire an advantage in six others but would remain in a difficult competitive position in eight categories against "typical" U.S. firms. For the fifteen clothing categories, the overall cost disadvantage against "typical" U.S. firms would be around two per cent, and against "best" U.S. firms, 14 per cent.

It must be emphasized that these results could be somewhat optimistic. In effect, as mentioned previously, the data on cost structures

Table 16

**CANADA - UNITED STATES**  
**PRODUCTION COSTS AND INDICES OF PRODUCTION COSTS**  
**FOR FIFTEEN SELECTED CLOTHING ITEMS AFTER ELIMINATION OF**  
**CUSTOMS DUTIES ON TEXTILE COMPONENTS**

(In Canadian dollars per dozen; costs of best American firms = 1.000)

Clothing Items	Canadian Dollars				Indices			
	Cost In Canada		Cost In United States		Cost In Canada		Cost In United States	
	Best	Typical	Best	Typical	Best	Typical	Best	Typical
	firms	firms	firms	firms	firms	firms	firms	firms
Ladies' sweaters	93.54	108.72	99.33	110.70	0.942	1.095	1.000	1.114
Jogging suits	406.39	508.84	438.08	519.49	0.928	1.162	1.000	1.186
Men's suits (grade 2)	1,199.58	1,332.98	1,259.26	1,362.70	0.953	1.059	1.000	1.082
Ladies' blouses	113.22	137.28	120.90	140.80	0.936	1.135	1.000	1.165
Ladies' dresses	184.90	223.47	195.89	228.16	0.944	1.141	1.000	1.165
Ladies' reversible jackets	621.94	747.30	648.60	755.50	0.959	1.152	1.000	1.165
Men's dress slacks	168.93	195.47	166.23	185.63	1.016	1.176	1.000	1.117
Brassieres	45.62	50.01	43.66	46.70	1.045	1.145	1.000	1.070
Ladies' skirts	111.16	130.87	110.08	124.35	1.010	1.189	1.000	1.130
Men's briefs	15.46	16.39	14.56	15.14	1.062	1.126	1.000	1.040
Men's dress shirts	91.21	100.59	89.71	97.70	1.017	1.121	1.000	1.089
Children's pyjamas	63.00	72.42	60.85	79.19	1.035	1.190	1.000	1.301
Ladies' T-shirts	28.35	32.12	27.56	30.44	1.029	1.165	1.000	1.104
Men's knit shirts	82.69	91.51	79.98	87.15	1.034	1.144	1.000	1.090
Men's jeans	140.88	149.65	133.01	139.41	1.059	1.125	1.000	1.048

SOURCE: Report by Kurt Salmon Associates-Canada Ltd.

include neither depreciation of fixed assets nor financial costs, and profits even less. These are important omissions with regard to total costs which could have a negative effect on the results obtained.

These results concerning costs after elimination of customs duties should not surprise. In fact, yarns, fabrics and other accessories account for only 30 per cent of total costs of the clothing industry according to inter-industry relationship tables (input-output tables). Therefore ten or twenty per cent duty on thirty per cent of total costs would lower the latter by three to six per cent only, all other things remaining equal.

A more complete analysis of the relationship between customs tariffs and competitive ability would require a knowledge of the effective rate of protection. Dean R. Dauphin and Mr. M. Smereka of the University of Sherbrooke have prepared a report for the Board on this subject. Only their conclusion is cited here:

"The study of Canadian-American trade in the textile and clothing industries and its evolution during the last five years leads us to believe that in the short term the Canadian industry could find itself in a difficult position in an eventual free trade area. The results of these calculations of effective rates of protection point in the same direction: the lowering effect on the costs of raw material supplies being much less than the implied decrease in selling prices of the products marketed by the Canadian firms."(1)

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- (1) Clothing manufacturers would see their costs decrease following the elimination of duties on fabrics from the United States, but would also see their prices diminish by the amount of duty protecting the industry. In fact, they would lose the protection applicable to their added value.

If a comparison is now made of the structure of total costs in the Canadian and U.S. clothing industries, it will be seen that there is a systematic difference in labour costs and in the costs of fabrics and findings. For the fifteen clothing categories without exception the share of labour costs in total costs is less in Canada than in the United States, while the share of costs of fabrics and findings is greater (Table 17). This difference is explained by the respective unit labour costs and fabric costs in both countries. One hour of work in Canada, keeping in mind the exchange rate prevailing at present, costs less than in the United States while fabrics and findings are more expensive.

There is, therefore, no similarity in the respective cost structures of the textile and clothing industries. In the textile industry, it is the presence or absence of economies of scale which account for differences in relative costs. In the case of clothing, it is unit costs which determine the cost relationships.

With regard to the other costs, i.e., manufacturing overheads and selling and administrative costs, there are no substantial differences between those in Canada and those in the United States. Manufacturing overheads, which exclude depreciation costs for fixed assets or financial costs, account for a share of total costs sometimes greater, sometimes smaller, in Canada than in the United States. Selling and administrative costs, which include the costs of transportation to distribution centres, are marginally higher in Canada than in the United States(1).

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(1) It will be noted that selling and administrative costs are values assigned by Kurt Salmon Associates which represent their best estimates of the magnitude of these costs. For Canada, these costs are estimated at 25.4, 22.5 and 18.7 per cent depending on the products, while for the United States they are estimated at 24.2, 21.3 and 18.0 per cent.

Table 17

**CANADA - UNITED STATES  
COST STRUCTURE FOR CLOTHING ITEMS**

(In per cent of total cost)

Products	Direct labour and fringe benefits				Manufacturing Overhead				Raw Materials and Other Accessories				Selling, General and Administration			
	Canada		United States		Canada		United States		Canada		United States		Canada		United States	
	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms	Best firms	Typical firms
Ladies' sweaters	21.2	23.1	25.4	26.7	23.4	25.6	24.6	25.9	30.0	25.9	25.8	23.2	25.4	25.4	24.2	24.2
Jogging suits	39.0	42.9	45.4	48.0	9.8	10.9	10.1	10.8	25.8	20.8	20.2	17.0	25.4	25.4	24.2	24.2
Men's suits (Grade 2)	22.6	26.1	28.2	30.7	5.8	6.8	6.0	6.6	46.2	41.7	41.6	38.4	25.4	25.4	24.2	24.2
Ladies' blouses	35.9	39.9	42.4	45.2	8.6	9.7	9.0	9.6	30.2	25.1	24.4	20.9	25.4	25.4	24.2	24.2
Ladies' dresses	34.3	38.5	41.0	43.6	8.3	9.4	8.8	9.9	32.0	26.7	26.0	22.3	25.4	25.4	24.2	24.2
Ladies' reversible jackets	28.4	33.4	35.4	39.1	7.0	8.3	7.7	8.6	39.1	32.9	32.7	28.1	25.4	25.4	24.2	24.2
Men's dress slacks	27.7	32.8	32.5	35.9	5.8	6.5	6.1	6.8	43.9	38.2	40.2	36.0	22.5	22.5	21.3	21.3
Brassieres	28.0	31.1	31.4	33.6	7.3	8.1	7.4	8.0	46.1	42.1	43.2	40.4	18.7	18.0	18.0	18.0
Ladies' skirts	30.7	35.0	36.3	39.5	7.8	9.0	8.4	9.2	39.1	33.6	34.0	30.1	22.5	22.5	21.3	21.3
Men's briefs	22.3	24.6	25.2	26.7	5.6	6.2	5.7	6.1	53.4	50.5	51.2	49.2	18.7	18.7	18.0	18.0
Men's dress shirts	27.3	30.1	32.5	34.9	7.4	8.3	8.1	8.8	42.8	39.1	38.2	35.0	22.5	22.5	21.3	21.3
Children's pyjamas	23.9	28.4	28.3	31.6	7.3	8.8	7.9	8.9	50.1	44.0	45.8	41.5	18.7	18.7	18.0	18.0
Ladies' T-shirts	26.3	30.5	31.1	34.5	6.2	7.3	6.6	7.4	48.8	43.5	44.3	40.1	18.7	18.7	18.0	18.0
Men's knit shirts	20.9	24.4	25.7	28.8	5.7	6.7	6.4	7.2	50.9	46.4	46.6	42.7	22.5	22.5	21.3	21.3
Men's jeans	15.0	17.8	17.8	20.1	3.3	4.0	3.5	4.0	63.0	59.6	60.7	57.9	18.7	18.7	18.0	18.0

SOURCE: Report by Kurt Salmon Associates-Canada Ltd.



In clothing as well as in textiles Canadian producers have an advantage in relation to utility costs (energy and water). However, this advantage is so minimal in clothing manufacturing that these costs are not even identified as such but are simply included in manufacturing overhead.

### Some Specific Aspects of Competitive Ability

According to the expert opinion of Kurt Salmon Associates, the Canadian textile and clothing industries are not lagging behind in terms of production technology, the "best" Canadian firms are comparable to the "best" U.S. firms, and "typical" Canadian firms as well are comparable to "typical" U.S. firms. In contrast, however, we have seen that most of the products of Canadian textile and clothing firms do not have a competitive advantage over their U.S. competitors.

This absence of competitive advantage is primarily the result of differences in the general configuration of markets in the two countries. In Canada, the markets for textile and clothing products are limited in volume, geographically dispersed and relatively unstable because of heavy concentration of the retail trade. In comparison, markets in the United States are large, their regional dispersion has less significance with the various regional markets being equal to or larger than the whole Canadian market, and the distribution channels are less centralized. Therefore, in order to survive, the Canadian producer finds himself in the position of having to offer a greater variety of products made in shorter production runs, thus utilizing his equipment and his labour force in a less efficient manner, and experiencing higher sales and administration costs as a result of his varied production and the dispersion of his markets. Moreover, the Canadian producer cannot specialize his production since he would then become more vulnerable to fashion changes and to the degree of success or failure of the products he would have chosen to market, thus

sacrificing the stability of his profits in return for greater efficiency. U.S. producers do not have to face these situations.

Added to this, as mentioned before, is the fact that Canadian producers are at a disadvantage vis-à-vis their U.S. counterparts with regard to their raw material costs which are close to international prices and to which custom duties must be added. These custom duties more or less compensate for the disadvantages resulting from differences in Canadian and U.S. market configurations at all levels of production, from raw materials to finished products.

Furthermore, Canadian producers generally have higher financial costs than U.S. producers, since short and long-term interest rates in both Canada and the United States are equal only on very rare occasions.

In contrast, the equipment utilized in the textile and clothing industries of both countries often come from the same sources at identical prices. In this respect, conditions are therefore the same for producers in both countries.

Finally, because of relatively low rates for electricity, natural gas and water, Canadian producers have an advantage, but it is only minor, since energy and water constitute relatively marginal inputs for the great majority of producers.

However, these four cost elements - raw materials, financial costs, equipment, energy and water - do not complete the list of factors which affect competitive ability. There are some others which must also be considered.

### Labour Force

The labour force is one of the most important factors affecting competitive ability. Labour force considerations comprise not only those relating to wages and social charges, but also include those concerning labour availability and its degree of skill, and labour relations in general.

When expressed in terms of average hourly earnings in the same currency, the remuneration of the labour force in the textile and clothing industries has evolved in a relatively parallel manner in both Canada and the United States (Table 18).

Moreover, during the last four years, the spread in hourly earnings between Canada and the United States for the textile and clothing industries has never been more than 2 per cent. In contrast, during the same years, average hourly earnings in the Canadian knitting industry have systematically been 10 - 11 per cent less than earnings in its U.S. counterpart. This spread is explained by the fact that the Canadian knitting industry has been experiencing a difficult adjustment period for about ten years, more specifically in the knit fabric sector, where normally the wages are higher than in the knit garment sector.

If average hourly earnings in the textile and clothing industries have evolved in identical manner and have been at the same level in both Canada and the United States during the last few years, while those in knitting were at a lower level in Canada, this is due in very great part to the gradual drop in exchange rate of the Canadian dollar in relation to the U.S. dollar. Should the Canadian dollar gain a few points against the U.S. dollar, the situation would change, with average

hourly earnings in the Canadian textile and clothing industries becoming higher than in the United States: the Canadian industries would then have to contend with a substantial competitive disadvantage.

Average hourly earnings mentioned up to this point have been calculated on a national basis and give no measure of the extent of regional differences. However, these differences are significant in Canada as well as in the United States.

Table 18

**CANADA - UNITED STATES  
AVERAGE HOURLY EARNINGS OF PRODUCTION WORKERS  
IN THE TEXTILE, KNITTING AND CLOTHING INDUSTRIES**

(In Canadian dollars)

	1980		1981		1982		1983	
	Canada	United States	Canada	United States	Canada	United States	Canada(1)	United States
Textile Industry	6.44	6.30	7.06	7.07	7.82	7.78	8.31	8.36
Knitting Industry	5.01	5.57	5.57	6.15	5.99	6.67	6.23	7.00
Clothing Industry	5.31	5.23	5.76	5.78	6.24	6.21	6.61	6.47

(1): March to December 1983 only, data for the first two months of the year not being comparable to data for other months as a result of Statistics Canada changing the universe of the survey.

SOURCE: Statistics Canada, Cat. 72-002, Employment, Earnings and Hours; U.S. Department of Labour, Employment and Earnings; and Bank of Canada Annual Conversion Rates.

In Canada, average hourly earnings in the textile industry are 17 per cent higher in Ontario than in Québec (the production of man-made fibres, a high wage sector, is concentrated mainly in Ontario). For clothing, however, average hourly earnings in Québec are the highest, those for Ontario being 11 per cent lower, and those for Manitoba, 17 per cent lower.

In textiles, in the United States, assuming that average hourly earnings in the State of New York equal 100.0, they are higher in California (107.0) and South Carolina (106.9), and lower in North Carolina (99.5) and Texas (98.3). In contrast, average hourly earnings for clothing are highest in the State of New York (100.0) followed by California (90.6), Texas (78.9), and South and North Carolina (78.4 and 78.2 respectively).

In the large regions of the United States and Canada where the textile industries are located, labour has been and continues to be available, even if these industries continue to search for locations where their costs could be lower. This is particularly the case for the clothing industry which tends to install sewing plants in rural areas where employment for women is rare and wage rates are lower. For the majority of workers in these industries the skills required are not too complex and can be acquired within a relatively short training period. This is not the case, however, for some highly skilled jobs such as those of cutters, mechanics, and dyers, whose training is much longer and more complex.

Apart from the availability and degree of skill of the labour force, the quality of labour relations plays an important role in the selection of locations for firms. Textile industries as a whole are highly

seasonal and cyclical. The more the working conditions are regulated, the more rigid is the framework within which the industry can operate, while on the contrary the latter requires a great deal of flexibility. Actual or potential rigidity which can be imposed by a collective agreement or by government regulations is shunned by company owners who tend to prefer locations where labour unionization is minimal and government regulations are fewer. For these reasons, Southeastern and Southwestern United States are considered as choice geographical locations by many Canadian textile and clothing producers: the labour force in these locations is relatively large, wages are moderate, and labour relations as well as government regulations are relatively favorable.

However, these considerations are tempered by other practical considerations which also have their importance. Thus, in the clothing industry, quality of work and quality of product are generally closely linked together. Therefore, when skilled labour is concentrated in large urban centres or has been patiently developed at great cost in smaller centres, the geographic mobility of firms will be greatly diminished, particularly those firms producing high quality clothing.

#### Tax Considerations

In considering taxes, it is the impact of corporation income taxes and not that of personal income taxes which must be taken into account. Effectively, corporation income taxes have a direct influence on competitive ability, while personal income tax is of less importance, its impact corresponding largely to the difference in benefit payments by the various governments in both countries.

The last comprehensive study on the subject goes back to the end of 1978<sup>(1)</sup>. Its conclusions were as follows:

"To summarize, business firms in Canada benefit in general from lower income taxes than in the United States. The tax burden is lower at both corporate and shareholder levels. The difference in effective and marginal tax rates for shareholders is appreciably larger than for corporations because of the dividend tax credits available in Canada. This difference exceeds 20 percentage points in favour of Canada in certain sectors. The credit is particularly attractive for small firms in Canada, since it results in combined corporation and individual tax rates payable lower than for comparable income from sources other than corporations"<sup>(1)</sup>.

To our knowledge the situation has not changed considerably since the end of the 1970's: corporation income taxes and their relative weight have remained relatively stable in both countries. In general, the tax burden on corporations is, therefore, somewhat lighter in Canada than in the United States.

Local taxes must also be considered in addition to federal and provincial taxes. Because of variations, sometimes quite substantial, which can exist between the various municipalities in Canada as well as in the United States, it is difficult to reach clear conclusions in this respect.

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(1) The Tax Systems of Canada and the United States, Department of Finance, Canada, Ottawa, November 1978.

### Transportation Costs

Transportation costs of textile and clothing products are not large, but are nevertheless significant. First, Canada must import almost all of the natural fibres and a portion of the man-made fibres used in textile production. Second, Canada also imports close to half the yarns and fabrics consumed in Canada. Finally, with textile and clothing production concentrated in specific areas, the resulting products must be distributed over long distances within Canada itself.

In the United States the textile industry is concentrated in the fibre producing regions, thus eliminating this first transportation cost. Yarn and fabric imports in the United States are proportionately much less important, which results in other savings in transportation costs. Finally, a part of the clothing industry is situated in textile regions and does not have to incur transportation costs for fabrics, as is the case in Canada. However, clothing products must then be transported over long distances as in Canada.

It should also be pointed out that the transportation sector in Canada is regulated, while in the United States deregulation of transportation is already well advanced. As a result, transportation rates are higher in Canada than in the United States. At first glance, Canadian producers would appear to be at a distinct competitive disadvantage in terms of transportation.

However, if this transportation problem is considered in relation to a potential free trade area, the competitive disadvantage could well be only marginal. In effect, Canadian producers would aim primarily at conquering regional U.S. markets within their reach, where



transportation costs can be minimized. As a result, a potential free trade area could strengthen North-South exchanges and reduce those in the East-West direction. This trade restructuring would imply significant savings in transportation costs. However, unless a free trade area is established, the structure of transportation rates in Canada will continue to be regulated in such a way that East-West rates will be more favorable than North-South rates.

Should negotiations be undertaken between Canada and the United States concerning the establishment of a free trade area a revision of the transportation rate structure in Canada would become desirable.

#### Construction Costs

Textile and clothing production requires not only equipment, but also buildings. In this respect, the price of industrial buildings or the cost of their construction constitutes one of the elements which, taken together, determine competitive ability.

In Canada, because of the severity of the climate, industrial buildings must be built on more substantial foundations than in the "Sun Belt" states of the United States. These foundations must in fact reach to or below the frost line in the soil for the whole extent of the building, whereas in the warm climates of "textile states" in the United States grading work and a layer of gravel are sufficient preparation to pour the concrete floor. In addition, the foundations for the walls, the walls themselves and the roof structure must be more resistant in Canada than in warm climates in order to bear a snow load for several months of the year. Lastly, insulation of industrial buildings is more costly in Canada than in the "Sun Belt" because more insulation is required against heat loss than against heat penetration.

Under these conditions, and keeping in mind the fact that wages paid in the construction industry are relatively high in Canada, it is probable that an industrial building in Canada would cost 25 or 30 per cent more than an identical building in the southern United States. This difference in cost does not cover land prices, since the latter are determined on the basis of variables which are too numerous to allow valid comparisons. It also does not take into consideration the financial costs incurred during construction which are generally higher in Canada because all interest rates are also generally higher in this country.

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Overall, Canadian textile and clothing industries, in terms of their competitive ability, are not in a strong position vis-à-vis their U.S. counterparts. Among the major factors governing competitive ability, only wages represent an advantage. However, this is rather marginal, and is entirely tied to the present level of exchange rate between Canadian and U.S. dollars.

Competitive ability is governed by more than the measurable factors already discussed. It is also influenced by numerous qualitative elements which, under certain conditions, can compensate for the disadvantages. Notable among such elements are product quality, flexibility of production, and quality of service to the user.

For obvious reasons, Canadian textile and clothing industries are generally at a disadvantage with regard to product standardization and economies of scale. In contrast, they appear to be in a better position with regard to advantages related to product quality, flexibility of production and quality of service.

#### **4. SPECIFIC PROBLEMS RELATED TO A POTENTIAL FREE TRADE AREA IN TEXTILE AND CLOTHING PRODUCTS**

Having considered the various cost elements in relation to the more general question of competitive ability, we will now discuss some problems which are specific to the textile and clothing industries and which could affect these industries in Canada in a potential free trade area. These specific problems are the result of some structural aspects of these two industries, in particular foreign ownership - i.e., U.S. ownership - of part of these industries in Canada; the relatively widespread practice of producing under licence in the clothing industry; the lack of exporting experience of most firms; and the use of imported inputs in the manufacture of clothing in Canada, which gives rise to the question of domestic content of products to qualify for free trade.

##### Foreign Ownership in Textile and Clothing Industries

Generally, foreign ownership, and particularly U.S. ownership, of textile and clothing firms is less prevalent than in other manufacturing sectors. The textile and clothing industries are even singled out by the fact that the overwhelming majority of the firms are owned by Canadian citizens.

Nevertheless, and as in other sectors, foreign ownership of part of these industries is a fact and, moreover, this foreign ownership is concentrated in a number of specific areas of textile and clothing production. In this respect, the man-made fibre sector and part of the man-made yarn and fabric sectors are owned by foreign firms. Foreign ownership is relatively prevalent in some standardized clothing products, particularly in hosiery, pants, men's shirts, swimwear etc.

Because of the fact that all the U.S. automotive firms owned Canadian subsidiaries, it was possible in the Automotive Pact to take advantage of the overall foreign ownership of this sector by obtaining from the firms specific commitments to maintain investments, production and employment in proportion with their total Canadian sales. Comparable commitments in the textile and clothing industries would be more difficult to obtain because only few American firms have Canadian subsidiaries while the majority have none.

Consequently, the Canadian subsidiaries of U.S. firms, in the context of a potential free market, could be subjected to a major process of adjustment and rationalization. Subsidiaries whose total costs are comparable to those of American plants would, without doubt, become much more specialized than at present and would produce for that part of the integrated market for which they are well situated geographically. Canadian subsidiaries with higher total production costs than U.S. plants could see their future seriously jeopardized. Future prospects could turn out to be very poor for certain parts of the man-made fabric sector, in view of excess production capacity already existing in the United States which is equal to or even larger than the total Canadian production of this sector.

Other difficulties arise for the Canadian subsidiaries which do not produce the same range of products as their parent company. For example, if the U.S. parent firm produces fibres only while the Canadian subsidiary produces yarns and fabrics in addition, it is unlikely that the parent firm would view with favour the competition in yarns and fabrics of its Canadian subsidiary against its U.S. clients. The Board did not discuss these problems with the management of U.S. parent firms, since it did not have the mandate to do so. It is possible, however, that direct contacts with U.S. management in a framework of negotiations could minimize these problems concerning the future of Canadian subsidiaries of U.S. firms.

### Production under Licence

Many Canadian firms, particularly in the clothing industry, account for a substantial volume of sales by making under licence various products with internationally known trade marks. Licensing agreements in effect allow, on payment of a royalty or fee, exclusive use in Canada of a U.S. or international trade mark for a period of time specified in the agreement.

In a free trade area the future prospects of producers under licence would be in doubt. In effect, a free trade area creates a single territory within which products circulate without restriction, and particularly without being subject to customs duties. As a result, the reason for granting a licence would cease to exist, and it is probable that many holders of U.S. trade marks would take back for themselves the exclusive utilization of their trade mark and would terminate their licencing agreements with Canadian producers.

Canadian producers holding U.S. licences would not be the only ones affected, but also those holding other than U.S. licences. In such cases, the fashion designer or the producer from a third country will try to consolidate his licencing agreements in one country only for the whole free trade area. Most often only one licenced producer would be sufficient to handle production for the whole area, and, considering the respective sizes of the Canadian and U.S. markets, this producer would likely be from the United States.

The problem of producers under licence would seriously affect Canada because of the greater role of U.S. trade marks in its market than the role of Canadian trade marks in the United States. This disparity is mainly due to the large expenditures which must be made to create a trade

mark enjoying general recognition. Few Canadian producers manage to establish their trade mark across the whole of Canada, and those who have tried to do the same in the United States are even fewer.

### Management and Marketing

The Canadian textile and clothing industries have never been really involved in exportation of their products. Firms with experience in this area are rare, and the great majority of firms are not organized to achieve in the short term a significant thrust in the U.S. market. Many Canadian producers are at a loss as to how they could accomplish such an undertaking, in view of the magnitude of the financial means they would have to engage to become known in the United States.

With regard to textiles and clothing, the United States constitute a large market with a large distribution network, whose doors seem impassable in the eyes of many Canadian producers. However, a majority of the latter are convinced that a minor success in the U.S. market would be equivalent to a major achievement in the Canadian market, and that the probability of success in the United States would be somewhat facilitated by distribution networks less concentrated in the United States than in Canada.

In terms of marketing, Canadian producers recognize that it would be illusory to want to conquer "the U.S. market". The latter is compartmentalized into a large number of regional markets according to climate, average income, degree of urbanization, and several other criteria. As a result, to be realistic, the Canadian producer would try to progressively infiltrate the regional markets for which he is best situated and with which his production has the most affinities.

Moreover, in order to succeed, he would have to offer products which, to a certain extent, are "different" from U.S. products. To be singled out in the mass of products offered, the Canadian producers would have to stand out by reason of the quality of their fabrics, their design, their workmanship and their service to the retailer. In this manner their products could find specialized "niches" and create a regular demand for them.

Dynamic marketing in the United States would evidently require considerable financial resources. In effect, it would require the organization of a permanent presence in the market with one or more show-rooms in the major garment trading centres; it would also be necessary to have a network of well-known sales people, and of warehouses which would enable satisfying the demand without delay. The largest Canadian firms could set up such facilities for themselves. The smaller ones probably would not have the means to do so alone, but they could organize themselves into export consortia of complementary products compatible in terms of quality, price and design.

Even if they clearly understand the difficulties, many Canadian producers are confident that they could find a market for their products in the United States. They are also aware that in such a case market penetration of their products would be only gradual, because they see no possibility of an immediate, spectacular entry. However, what worries them most is the disparity between their difficulties in entering the U.S. market and the facility with which U.S. firms can penetrate the Canadian market. In fact, numerous U.S. products are already well known to Canadian retailers and consumers because of the widespread diffusion of U.S. fashion magazines in Canada, and of the U.S. television programs seen in Canada, while Canadian products are little known in the United States. Should it happen that U.S. products be distributed in large quantities by Canadian retailers while Canadian products would only be starting to penetrate the U.S. markets, the position of Canadian producers would be seriously weakened.

It is this fear of erosion of their domestic situation which is behind some of the demands which Canadian producers have expressed to the Board. In their opinion, the Canadian producers will be able to face this potential erosion of their situation only on condition that they benefit from temporary assistance programs covering several aspects of their activities.

The Canadian producers would like first to be able to benefit from an investment assistance program similar to the one administered by the Canadian Industrial Renewal Board. Such assistance would make possible those adjustment and modernization investments necessary to enable the Canadian industries to adapt rapidly to the new reality of a free trade area and to reorganize their production accordingly.

The Canadian producers would also like to benefit from a marketing assistance program for their products. This program could provide partial coverage of the costs of studies of selected markets, product display, publicity, and establishment of sales offices or export consortia.

Lastly, the Canadian producers would like to be supported by a design assistance program. Numerous Canadian producers, notably the smaller ones, believe that design should be considered an intrinsic part of the structure of the industry on the same basis as equipment. In making design less onerous for the producer, the program would contribute to the generalization of quality design in the same manner as CIRB contributes at present to the generalization of modern production technologies.

The Canadian clothing producers believe they have a chance of succeeding in a free trade area with the United States on condition that they be helped in facing the multiple challenges involved in adapting



their products and their plants to the new market, in reinforcing their management and in organizing an efficient marketing system in the United States.

The rate at which they could adapt to this new market depends on two factors: the adjustment assistance which could be offered by governments, and the assistance required to counteract the apprehended erosion of their domestic markets by increased imports from both the United States and low-cost countries. This potential double erosion of their markets worries the majority of Canadian producers to the point where many are convinced that they will be able to face this challenge only if imports from low-cost countries in particular are temporarily stabilized. If these imports continue to increase at a rate similar to that of recent years, the producers doubt that they could generate sufficient funds to finance their adjustment to a free trade area.

With respect to adjustment to an enlarged market, Canadian and U.S. industries are in different positions. Because of the disparity in size of the two markets, considerable adjustment would be required on the part of Canadian producers, while U.S. producers would need little or no adjustment. The only real challenge to U.S. producers is to face competition from low-cost countries.

#### Domestic Content of Products Qualifying for Free Trade

Since many clothing components are imported in Canada as well as in the United States, a free trade area would require an agreement between the two countries with respect to rules of origin. Effectively, only those products which could be considered as originating in one or the other country would qualify for free trade.

Rules of origin can be defined in two ways: either they stipulate which production processes must be carried out in the country of origin, or they determine the portion of manufacturing costs which must be incurred in that country.

If the sectoral free trade area involved only textile and clothing products, either method could be utilized since the major production phases are relatively few, and manufacturing costs can be determined fairly accurately.

If the first method is adopted, it would be possible to stipulate, for example, that for fabrics, at least two of the three production steps (spinning, weaving, dyeing and finishing) be carried out in the country of origin. Similarly, for clothing, the major steps in the production process should be identified, and the number of required steps defined, in order to determine origin. Negotiation of an agreement on rules of origin is a complex matter, since the various sub-sectors have diverging interests. Thus, if it were specified that for any article of clothing, weaving, cutting, sewing, and finishing would be required in order to consider the product as originating in a given country, those garments made of fabrics coming from third countries could not qualify for free trade. Such conditions would also mean that U.S. garments produced under section 807 (which allows U.S. producers to cut U.S. fabrics in the United States, ship them for sewing to countries with lower wages, and have them returned to the United States while paying customs duties only on the value of the sewing operation), would not qualify for free entry into Canada.

Should the second method be chosen, the result would apparently be a simpler and more uniform system. Nevertheless, depending on whether the proportion specified would amount to 40, 50 or 60 per cent, some

production steps would, by definition, be excluded from or included in the domestic content, and the final results would be analogous to those for the first method.

As can be seen, an agreement on rules of origin is of great importance, requiring careful preparation and thorough consultation with representatives of the various sub-sectors of the textile and clothing industries. Indeed, a difference of a few percentage points in mandatory domestic content could easily spell all the difference between success and failure in a number of sub-sectors. It is therefore less than certain that uniform criteria for all sub-sectors would be satisfactory, even if this uniformity would ensure simplicity and transparency in the administration of the system.

Finally, it should also be mentioned that rules of origin would operate in a cumulative manner within the free trade area. Any transformation carried out in one of the two countries would be added to any further transformation in the other country. A Canadian garment made with U.S. fabric would evidently have originated within the free trade area.

#### Transition Period

In the past, no free trade area has been established overnight. Each has been preceded by a transition period of greater or lesser duration.

The majority of Canadian producers consider that a transition period should precede the implementation of a free trade area. Only a

small minority, composed of producers already selling a significant part of their production in the United States, do not agree on the usefulness of a transition period and would be prepared to enter into a free trade area with minimum notice.

The producers who believe that a transition period is necessary were unable to agree on a suitable length of time for such a period. They have suggested transition periods of 3, 5, 10, and even 15 years, depending on the degree of adjustment required. During this transition period, customs duties and other trade barriers between Canada and the United States would be progressively reduced so as to eventually disappear at the end of the period.

With regard to transition periods, it should be noted that too long a period is undesirable because it leads to postponement of essential adjustments. Periods of three to seven years could be considered sufficient if there is a real will to create a free trade area.

The Board's hearings have also brought out the fact that there are major differences in the positions of the Canadian producers regarding this transition period, and no consensus could be arrived at in this respect.

One difference concerns the necessity of coordinating the transition periods in the textile industry and in the clothing industry. The majority of producers recognized that adjustment of the textile industry would be more difficult and would, therefore, take longer than adjustment in the clothing industry. However, it would be desirable for the clothing industry to benefit from the advantages of a free market for textiles before undertaking the liberalization of trade in clothing products. Thus, if the transition period for clothing were to start only at the end

of the transition period for textiles, the result would be an overall transition period too long to be efficient.

Another difference relates to the length of transition periods in Canada and in the United States. Since Canadian producers consider that they would have to battle for recognition and acceptance of their products in the United States while U.S. producers would not have to do so to make their products known in Canada, many manufacturers have concluded that it would be preferable for the United States to immediately open its frontiers to Canadian textile and clothing products, while Canada should count on a transition period of several years to do so, during which the Canadian tariff barriers would be progressively lowered before disappearing completely.

## **5. ALTERNATIVE TO A FREE TRADE AREA: DUTY REMISSION**

Most sectors of the textile and clothing industry are apprehensive about a potential free trade area in textiles and clothing with the United States because they fear that the implementation of such a project would lead to an invasion of the Canadian market by U.S. products. For this reason, the Board has considered an alternative to a free trade area, that of a duty remission scheme more generalized than at present.

The General Agreement on Tariffs and Trade (GATT) contains no provision concerning duty remission. In Canada, the Customs Act provides for possible duty remission when the products are imported under conditions specified in the Act or when Orders-in-Council are issued under the authority of this legislation.

The Canadian system of duty remission allows only the remission of regular ad valorem or specific duties applying to specified products. Moreover, the category of importers who can avail themselves of this privilege is specified in most cases.

However, the Canadian Act does not discriminate with regard to the country of origin of the product. Because of its non-discriminatory character, it therefore respects GATT stipulations. In fact, it is a unilateral concession which can benefit exporters of all countries since the country of origin of the imported product is not specified.

Canada already utilizes this approach in a number of cases and allows duty free imports of specific products not made in Canada. In the case which concerns us, it could do so with regard to a much greater number of textile and clothing products than at present. In this manner,

the Canadian producer making only part of a product range could import free of duty the other part of the range which at present he cannot produce himself economically because of the small size of the domestic market. Utilization of duty remission in such a way could be of considerable help in reinforcing the manufacturing base in this sector.

The suggestion of establishing a duty remission scheme as an alternative to a free trade area should not become the object of a unilateral concession, but should be looked at in terms of a bilateral approach whereby Canada and the United States would grant this privilege to each other for a given number of textile and clothing products.

Such a scheme would not be established without giving rise to certain problems.

A first problem would likely be raised by the GATT. While the GATT is not opposed to any unilateral measure which contributes to the development of international trade, it prohibits discrimination between countries except when a free trade area is being created. A scheme such as the one suggested would, in fact, discriminate against third countries.

A second problem would no doubt appear in the negotiations for a bilateral agreement on duty remission. A sectoral free trade area would apply to all products of the sector in question, and market forces would determine the winners and the losers. To be realistic, a duty remission agreement would require that, in both countries, governments determine the list of specific products which would be covered by the scheme and which would ensure that concessions granted and obtained would be in balance. In fact, no country is interested in granting more advantages than it would receive in return.

If Canada and the United States decided to proceed with duty remission without any formal agreement between them, that is, in a unilateral manner, the scheme would become acceptable to the international community only on condition that it be applied to all participating countries in the GATT. For producers and importers, such an arrangement would have the disadvantage of uncertainty: when a unilateral concession is involved, the conditions under which this concession has been granted can also be unilaterally modified and even cancelled.

Finally, it must also be pointed out that a duty remission scheme involves relatively high administrative costs. If the procedure selected is to exempt goods from duty at the time of importation, the customs authorities would have to verify if the goods imported are the ones specified, and if they are imported by authorized producers or importers for the specified end uses. If the selected procedure involved payment of duty by the importer at the time of importation with subsequent reimbursement by customs authorities, the controls required would be the same.

As to what this would mean for the importer, the remission scheme would require him to maintain at all times a complete file of relevant documents showing that the importer has the right to this preferential treatment and that the destination of the imported products is as stipulated in the conditions for duty remission.

In general, the establishment of a duty remission scheme would lead to some major difficulties:

- . Internationally, only non-discriminating unilateral concessions are acceptable, and a bilateral agreement for mutual concessions would go against GATT stipulations;



- . Such a scheme would have little attraction for the final consumer since he could not avail himself of the privilege of duty free imports restricted to producers, while normally, in a free trade area, he would be able to do so;
- . The duty remission scheme would not be exempt from anti-dumping action or countervailing duties to which it could give rise, whereas normally, a free trade area would eliminate the possibility of such actions;
- . Administrative costs for importers and customs authorities would be higher with a duty remission scheme than in a free trade area because in the first instance the product, its destination, and the importer would have to be verified; whereas in the second, only the country of origin would have to be verified;
- . The duty remission scheme could result in numerous uncertainties while a free trade area, once in place, is considered as an irreversible process.

## 6. SUMMARY

Although the GATT does not specifically provide for the possible creation of sectoral free trade areas, but nevertheless does not prohibit them provided certain conditions are fulfilled, the Board has proceeded to analyze the structure of the textile and clothing industries in Canada and the United States, and the elements which determine their competitive ability in relation to each other.

1. A comparison of structural characteristics shows that in both countries:

- the contribution of textile and clothing industries to gross national product and to employment in manufacturing is of the same order of magnitude;
- the textile industry is situated outside of the large industrial centres;
- the clothing industry is concentrated near the large consuming centres, even if satellite sewing plants are often established in less populous centres;
- very large firms dominate only a small number of primary textile sub-sectors, particularly those of man-made fibres and of cotton and man-made fibre yarns and fabrics; all other textile and clothing sub-sectors are typically dominated by medium or small size firms;
- the restraint measures applied to exports of low-cost countries are comparable: the values of textile and clothing imports from these countries being very close;

- bilateral trade in textile and clothing products is already relatively important;
- this trade is relatively specialized: in the various textile categories, Canada generally imports products with high unit values and exports products with low unit values; in contrast, in the various categories of clothing, Canada generally imports from the United States products of low unit values and exports products of high unit values;
- non-tariff measures of protection (labelling, product regulations, preferential purchasing from domestic producers, various forms of subsidies) are often different, but are far from being insurmountable.

In other respects:

- the size of the domestic market in Canada has never been sufficient to justify production of the complete range of primary textile products while the United States have never experienced this limitation;
- on a per capita basis, Canada imports considerably more textile products than the United States, while for clothing products the situation is similar in both countries;
- the tariff protection system in Canada is relatively simple and transparent, while the system in the United States is complex and allows considerable discretionary powers to the U.S. customs administration.

2. An analysis of the competitive ability vis-à-vis each country shows that:

- for textile products, and with few exceptions, the shares of total costs represented by direct wages, manufacturing overheads, and selling and administration costs are higher in Canadian textile industries than in those of the United States;
- however, in clothing products, the Canadian producers are at a marked disadvantage with standardized products such as jeans, sport shirts, T-shirts and pyjamas, but in contrast, have a slight advantage in products with more of a fashion content such as ladies' sweaters, blouses and dresses, sportswear and men's suits.

If, on the other hand, individual cost factors are examined, it is found that:

- Canadian textile and clothing producers are at a disadvantage vis-à-vis their U.S. counterparts regarding the cost of their raw materials at all phases of production;
- long and short-term interest rates are usually higher in Canada than in the United States;
- Canadian producers have a cost advantage in terms of energy and water;
- costs of machinery and equipment for Canadian producers are comparable to costs for U.S. firms;
- wages paid in Canada and in the United States are relatively close with, in fact, a slight advantage for Canada; however,

an increase of less than ten per cent in value of the Canadian dollar relative to the U.S. dollar would be sufficient to wipe out this competitive advantage;

- Canada has a slight advantage in corporation income taxes;
- transportation costs, following deregulation in the United States, are lower there than in Canada;
- construction costs of industrial buildings are about 25 to 30 per cent higher in Canada than in the United States;

The elimination of customs duties on fabrics and other supplies would not have a dramatic impact. Assuming that prices of fabrics and other supplies are lowered by the full amount of duty, the "best" Canadian firms would have a cost advantage over the "best" U.S. firms in six out of fifteen products, and compared to "typical" U.S. firms, would have an advantage in thirteen products out of fifteen.

Elimination of customs duties not only on fabrics and supplies but also on clothing would create difficulties for Canadian producers of several types of clothing: their costs would decrease as a result of the elimination of customs duties and the decrease in fabric prices, but their own selling prices would be decreased by the full amount of effective protection which they enjoy at present. The tariff protection on clothing effectively compensates for the disadvantage resulting from fabric protection, and in addition, protects the overall value added by clothing producers.

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However, competitive ability involves numerous qualitative elements which, under certain conditions, can compensate for the disadvantages in quantitatively measurable cost factors. This is the case for product quality and design, flexibility of production and quality of services to the buyer, in which Canadian producers appear to have an advantage.

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3. The proposal of a free trade area in the textile and clothing sectors also brings up other questions in addition to competitive ability:

- the question of Canadian subsidiaries of foreign firms, which are important in the man-made fibre, yarn and fabric sectors as well as in those of standardized clothing, for which sectors it would be necessary to obtain commitments from parent companies to protect investments, production and employment in Canada;
- the question of Canadian firms producing under licence, whose production agreements might not be renewed, since production under licence, given the size of the Canadian market, would likely be concentrated elsewhere than in Canada;
- the lack of experience of the majority of Canadian producers in marketing products in the United States;
- the obligation to offer products "different" from those produced in the United States, and to find appropriate "niches" for these products, all of which require important financial resources;

- the question of adjustment to a free trade area when U.S. producers have an advantage from the start in that their products are often well known by Canadian retailers and consumers while Canadian products are rarely known to U.S. retailers and consumers;
- the problem of constant erosion of the Canadian market under the pressure of imports from low-cost countries, which will contribute to weakening the financial position of Canadian producers who would then be unable to finance the necessary adjustments to free trade without governmental aid, such as assistance for investment, for design, and for marketing in the United States;
- the question of establishing rules of origin or of minimum domestic content of products to qualify for free trade, which would require careful preparation and thorough consultations with the producers of the various sub-sectors;
- the question of a transition period, which brings up the need to determine if the adjustment of the textile and clothing industries to a free trade area should be carried out concurrently or successively, taking into account the fact that adjustment of the textile sector should take longer than for the clothing sector, and to determine if the U.S. border should be opened immediately while the Canadian border would be opened only progressively, since the United States have little need for a period of adjustment to a free trade area while Canada needs such a period.

The proposal of a free trade area for textiles and clothing, therefore, gives rise to numerous problems and implies real risks.

The Canadian textile and clothing industry is aware of the risks as well as the potential advantages of a free trade area. Risks, because a portion of production, investments and employment could be shifted to the United States, particularly for standardized textiles and clothing. Potential advantages because Canadian producers of certain types of fabrics and clothing could see their inventive minds rewarded by access to a large market. They are under the impression that under the present conditions their market shares are systematically eroded to the advantage of low-cost countries. In a free trade area they could find a niche where they could be shielded better from competition from these countries, and the niche would be sufficiently large to justify additional investments and obtain an adequate return on investments.

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The participants in the study who manifested their apprehension of a free trade area expressed their preference for a less constraining alternative requiring less adjustment by industry, that is, a system of duty remission on imports of textiles and clothing. Canadian customs legislation provides for possible duty remission under certain conditions.

The implementation of such a system as a substitute for a free trade area would give rise to serious difficulties:

- the GATT allows duty remission only on condition that it be applied to products from all countries and not from one country only; duty remission is a unilateral concession by



the importing country in order to reduce the cost of imported products not made in the country, and not to promote bilateral trade;

- the governments of Canada and the United States could have serious reservations about a policy going against the established order of international trade;
- the governments of both countries could be reticent to prepare lists of specific products which would benefit from duty remission in both countries, while trying to ensure a proper balance between concessions given and received;
- such a system has little attraction for the final consumer since it normally reserves for producers the privilege of duty free importation.

**APPENDIX I**

**LIST OF PARTICIPANTS TO THE STUDY  
WHO PRESENTED BRIEFS TO THE BOARD  
AND/OR APPEARED AT PRIVATE HEARINGS**

	<b>BRIEF</b>	<b>HEARING</b>
Aero Garment Limited	x	x
Amalgamated Clothing & Textile Workers Union	x	x
Apparel Manufacturers' Association of Ontario	x	x
Ballin Inc.	x	x
Barry Manufacturing Company Limited	x	x
Bay Mills Ltd.		x
Bell Tootal Inc.	x	x
Bermatex Inc.		x
Bernard Cowan Inc.		x
Britex Ltd.		x
Brodkin Industries Inc.		x
Canadian Apparel Manufacturers' Institute	x	x
Caulfeild, Burns and Gibson Limited		x
Children's Apparel Manufacturers' Association	x	x
Canadian Carpet Institute	x	x
Canadian Textiles Institute	x	x
Celanese Canada Inc.	x	x
Centrale des Syndicats Démocratiques	x	x
Century 21 Apparels Ltd.	x	x
Claudel Inc.		x
Cleyn & Tinker Inc.		x
Cluett, Peabody Canada Inc.	x	x

	BRIEF	HEARING
Commonwealth Curtain Co.		X
Consoltex Canada Inc.	X	X
Consumers' Association of Canada	X	
Coppley, Noyes & Randall Limited	X	X
Dan Heap, M.P. for Spadina	X	X
Dance Originals and Tailored Juniors	X	X
Dominion Textile Inc.	X	X
DuPont Canada Inc.	X	X
Dylex Limited	X	X
Elite Blouse & Skirt Mfg. Ltd.	X	X
Forsyth Trading Co.		X
Gemini Fashions of Canada Ltd.	X	X
George Sheard Canada Inc.		X
Grand National Trouser Inc.	X	X
Hanson-Mohawk Inc.		X
Harvey Woods Limited	X	X
Huntingdon Mills Ltd.	X	X
International Ladies' Garment Workers' Union	X	X
Jantzen Canada Inc.		X
Jones Tent & Awning Limited	X	X
K-Brand Ltd.	X	
Koret Canada Inc.	X	X
Kovac Manufacturing Inc.	X	X
L. Davis Textiles Co. Ltd.		X
L.W.L. Ltée	X	
Lindzon Limited	X	X
Lutfy Ltd.	X	
Marquesa Fashions Inc.	X	
Midwest Garments Corporation		X
Monaco Group Inc.		X

	BRIEF	HEARING
Montreal Dress and Sportswear Manufacturers' Guild		x
Montreal Fast Print Ltd.		x
Morbern Inc.		x
Nalpac Inc.		x
Nova Scotia Textiles, Limited		x
Patons & Baldwins Canada Inc.	x	x
Paulman International Div. of Weston Apparel Manufacturing Company		x
Peerless Clothing Inc.	x	x
Rice Sportswear Ltd.		x
Riviera Slacks Inc.	x	x
Satexil Inc.		x
Silknit Ltd.		x
Silpitt Industries Co. Ltd.	x	x
Standard Knitting Ltd.		x
Stanfield's Limited	x	x
Stephen Kape Industries Inc.		x
Surrey Classics Manufacturing Limited		x
Tan Jay International Ltd.	x	x
Taran Furs Inc.		x
Textiles Dionne Inc.		x
Toronto Dress & Sportswear Manufacturers' Guild Inc.		x
Toronto Ontario Designers		x
Wabasso Inc.	x	x
Warren K. Cook Limited		x
Wescott Fashions Ltd.		x
West Coast Woollen Mills Ltd.	x	x
Western Glove Works Ltd.	x	x

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