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WRITTEN STATEMENT TO THE HEARING RECORD
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U.S. HOUSE OF REPRESENTATIVES SMALL BUSINESS SUBCOMMITTEE
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TEXTILE IMPORT ENFORCEMENT: IS THE PLAYING FIELD LEVEL FOR AMERICAN SMALL BUSINESSES?

Chairman Shuler and members of the Subcommittee, my name is Cass Johnson and as President of the National Council of Textile Organizations (NCTO), I would like to thank the Small Business Committee for holding this hearing on Textile Import Enforcement: Is the playing field level for American small businesses. This is an area of real importance because textile customs fraud means lost jobs for American workers and lost orders for American producers. At a time of immense hardship for the manufacturing sector, our government needs to take all actions necessary to make sure that our trade laws are faithfully executed. We sincerely thank you and the Subcommittee for pointing a spotlight on this area and we look forward to working with you, Customs and other agencies of the government to restore faith in trade agreements and their enforcement.

Textile and apparel customs fraud has been a serious problem for decades and, according to Customs and Border Protection (CBP), the textile sector attracts more fraudulent activity than any other industrial product. There are multiple reasons for this: 1) most large Asian suppliers have faced restrictions, or quotas, on some or all of their textile and apparel products exported to the United States, and 2) tariff rates on textile and apparel products are much higher than other industrial products, therefore the incentive to commit fraud is significantly higher. In fact, textile and apparel duties account for 40 percent of all duties Customs collects each year, which is estimated at \$10 billion per year, while textile and apparel trade accounts for only 4 percent of U.S. imports.

For many years, textile fraud was associated primarily with transshipment or quota evasion. China, in particular, sent enormous quantities of Chinese made goods through third countries in order to evade quota restrictions. The U.S. government responded by imposing electronic visa requirements, conducting overseas plant inspections and targeting high fraud countries for special operations.

In the past five years however, a new type of fraud has emerged that is centered on free trade and preferential trade agreements, particularly those in the Western Hemisphere (NAFTA, CAFTA, ANDEAN). This type of fraud involves using Chinese and Pakistani yarns and fabrics instead of U.S. or regional yarns and fabrics (which are mandated under such agreements) and then exporting the final apparel products duty free to the United States. This type of fraud is particularly damaging to U.S. and regional producers of yarns and fabrics because their orders are being displaced by the illegal Asian products. The end result is lost sales, production declines, plant closings, and workers being laid off by the thousands.

During the CAFTA negotiations, the textile industry was assured by the US government that the customs enforcement rules in CAFTA were the strongest and most comprehensive of any free trade agreement. However, the industry's faith in the government's willingness to enforce textile trade provisions was shaken by the revelation in 2005 that Customs had received \$9.5 million in congressionally mandated textile enforcement funds as part of the 2002 Trade Promotion Act ("fast track") but Customs had used the funds on other projects and hired 0 of the 72 congressionally mandated textile officers. As a result, during the CAFTA debate, the White House made new commitments to the textile industry that the CAFTA enforcement effort would be fully staffed and Customs would make enforcement a major priority. Harding Stowe, a member of NCTO's Executive Committee, hosted President Bush at his Belmont, North Carolina yarn spinning plant during the final push for CAFTA and discussed with the President the dangers that China posed to the textile industry vis-a-vis CAFTA. As it turned out, textile support was critical in the passage of CAFTA with textile House members providing the two final votes to pass the agreement.

After the passage of CAFTA, the industry was alarmed when the government took a number of steps which began to de-emphasize textile enforcement. The first in 2006 was to transfer the textile enforcement division out of Operations, which has responsibility for enforcement actions, to a new policy branch called the Office of Trade. This move took place without industry consultation and repeated a previous move from the late 1990's when Customs moved textile enforcement from Operations to a Strategic Trade Office. That move was later reversed when textile enforcement activities dramatically declined. Industry protests at the move were ignored.

With the move, the industry was concerned that, as in the past, enforcement efforts would become more difficult and more bureaucratic during a period of time when unscrupulous importers were becoming more sophisticated in getting around customs rules. This concern was borne out when senior staff quickly began leaving the new office and their positions were not filled. Since the reorganization was completed at the end of 2006, over half the senior staff have left the office to return to the 'field' which focuses on enforcement, or have left the agency altogether. This was an unprecedented reduction for an office that had been remarkably stable for many years. Textile staffing levels at headquarters declined by 35 percent as the staff has been reduced from 14 persons to 9 persons. This reduction came during a time of increased responsibilities as new agreements with the CAFTA region, Haiti HOPE, Peru and Oman were implemented.

As the CAFTA problems became more apparent, NCTO and the textile industry increased the amount of data and fraud information provided to Customs. As the industry testimony before this subcommittee indicates, the problem became especially severe in the area of ring spun cotton yarn. NCTO producers began to see abnormal price drops in 2007 as Chinese and Pakistani yarn was being relabeled "Made in the U.S." and sold to CAFTA knitters at prices as much as 30 percent under U.S. cost. Major orders were lost to shell companies such as "Yarns America" that were clearly phony and had no U.S. production. Other companies would and still are buying small amounts of U.S. yarn and co-mingling it with Pakistani yarn. U.S. mills were able to trace for Customs the route of the illegal shipments, from Karachi, Pakistan to Miami, Florida where the yarn was then re-exported to the CAFTA region. However, Customs lacked the resources and tools necessary to stop the activity.

By 2008, the ring spun yarn sector was being decimated. According to U.S. government statistics, in 2008 fraud accounted for at least half of “U.S.” exports to the region.

| Combed Cotton Yarn Fraud in CAFTA Region (2008) | | | |
|--|---------------------------------|---------------------|---------------------------|
| Total U.S. Production | U.S. Exports to CAFTA and NAFTA | Fraud Component | Fraud Percentage |
| 48 million kg | 91 million kg | At least 43 mil. kg | At least 50% ¹ |

One U.S. company, RL Stowe Mills, went out of business, ending a three generation company. RL Stowe had been one of the most vigorous companies trying to combat yarn fraud and had repeatedly supplied the government with information on which companies were buying and selling the illegal yarn. NCTO estimates that fraudulent ring spun yarn sales accounted for the closure of seven textile mills over the last two years.

The yarn sector is not the only sector hit by fraudulent players. Major U.S. fabric producers report that illegal woven fabric exports from Pakistan and China have taken large chunks of business away. In some cases, U.S. manufacturers have supplied the names of the foreign exporters, the name of the importing company and the names of the end users; however, Customs has still been unable to stop the illegal trade. In another instance, Customs recently examined entries of goods allowed under the CAFTA “short supply” mechanism and found that nearly every entry was fraudulent.

As this problem has grown and the industry costs from fraud have become more apparent, NCTO has been meeting regularly with Customs as well as the Commerce Department and the United States Trade Representative’s Office to review the problems with proper enforcement. It is clear from these reviews that Customs lacks the resources, the focus and the necessary tools to get this problem under control. An indication of this is the number of entries that Customs actually verifies for trade preference claims under the CAFTA/NAFTA/ANDEAN agreements. This number is shockingly low, less than 1,500 reviews last year out of an estimated more than one and half million claims². This comes out to an average of one entry out of every thousand, which means that most importers know that they can cheat and will get away with it with little chance of getting caught.

¹ Some U.S. production is consumed domestically and is not exported.

² NCTO estimate: assumes that average entry for a textile and apparel entry is \$7,500 with \$11.6 billion in preference claims in 2008. Other data is sourced from U.S. Customs and Border Protection and the International Trade Commission.

| Minimal Customs Verifications and Penalties for FTA Areas (2008) | | |
|--|---------------------------------|--|
| Total Trade from Preference Areas | Average Number of Verifications | Total Revenues Collected for False FTA Claims |
| \$11.6 billion | 1 out of every 1,000 entries | \$2.2 million or 2/100ths of a percent of trade. |

Customs figures also show that despite the huge volume of FTA textile and apparel trade – nearly \$12 billion last year – Customs only charged unscrupulous importers with only \$2.2 million in illegal trade preference claims, a false claims rate of only two one-hundredths of a percent.

RESOURCES & FOCUS:

As the system is currently constructed, NCTO is concerned that Customs lacks the necessary resources and focus to stop or at least deter this fraudulent activity. For example, the direction of all textile verification claims, special operations, ports visits, and textile factory inspections is managed by only two people in Washington DC. There is no specific focus on the trade preference areas and no personnel dedicated to fraud in the CAFTA/NAFTA region. In addition, the ports that handle the majority of CAFTA/NAFTA trade – Miami and Los Angeles – do not appear to be adequately staffed to do trade verification reviews and inspections. Customs also has no presence in the CAFTA region, nor any on the ground personnel to follow up on fraud charges. Customs has also halted regular training sessions for new agents in textile and apparel fraud because of cost concerns and promised training of CAFTA country foreign customs services on interdiction and enforcement never occurred. The later points are key details because fraud investigations are extremely complex and time consuming and usually require that Customs officers visit and verify actual overseas production sites.

In addition, the headquarters office, which provides focus and direction for textile enforcement activities, remains understaffed. Congressionally appropriated money for textile and apparel enforcement does not cover headquarters staff so it is perhaps telling that the agency, when left to its own discretion, has allowed staffing to fall to such low levels. Key responsibilities have also been moved out of the office, including special operations and textile trade policy. This dispersion of activities to other parts of the agency has slowed response time and effectiveness.

TOOLS

Even with increased staffing and focus, the task for Customs officers in ensuring free trade agreement compliance is enormous. One of the most sobering discoveries made during NCTO's review is that the customs compliance measures in place are inadequate to effectively enforce our laws. In essence, the industry was assured that compliance measures were strong when in fact they are easily evaded by determined players. Customs is forced under the current enforcement regime to spend inordinate

amounts of time trying to piece backwards a fraud trail that is obscured under multiple players, inadequate control systems and a lack of authority to take punitive action.

A prime example of this is the combed cotton yarn fraud. Even when NCTO member companies know who the foreign yarn producer is and who is receiving the illegal yarns (the knitter or weaver of the yarn) in the region, Customs still has a difficult task ahead in stopping the activity. For Customs to take action under the current rules, it must identify the importer of record, who is often unknown to the knitter or the weaver or the yarn spinner. In fact, many branded apparel retailers now use brokers, freight forwarders, or even foreign entities to be the importers of record, thus keeping their names “off the books.” This makes finding the importer of record even more difficult because he or she is often different than the final buyer.

But even when the importer of record is known, Customs’ task is still onerous. Because the yarn producer or the knitter or weaver has no idea what shipments its products go into, Customs must essentially make its best guess as to which entries of often thousands of entries by a given importer to examine. And even if that guess turns out to be correct, importers often demand that yarn and fabric producers supply only “blanket affidavits” attesting to origin. These affidavits merely state that the producer supplied some yarn or fabric over the course of a year and that such yarn or fabric was CAFTA qualifying. Unscrupulous importers often use copies of legitimate US affidavits for Pakistani or Chinese yarn - this makes it virtually impossible for Customs to determine whether one shipment contains U.S. yarns or another contains illegal foreign yarn. The end result is gridlock.

SOLUTIONS

The problems confronting textile and apparel enforcement are clearly complex and require multiple solutions. NCTO believes that only a coordinated effort which entails new resources, a stronger focus and improved tools will be successful in getting the fraudulent activity under control.

While NCTO is still consulting with Customs, USTR and the Commerce Department about specific solutions, the following areas clearly need to be addressed:

CUSTOMS RESOURCES, FOCUS AND STAFFING:

- 1) Headquarters staffing and focus: headquarters staffing needs to be expanded and re-organized. A dedicated Trade Preferences unit with at least four staff should be created and other branches needs to be brought up to full staffing. New staffing should be dedicated to review undervaluation issues concerning China and other major players. The number of trade verifications reviews needs to be dramatically increased.
- 2) Staffing of import specialists at ports that handle textile and apparel trade preference claims should be reviewed and expanded. The port of Miami should be specifically targeted for additional personnel.
- 3) A Rapid Response team of textile and apparel import specialists should be created at the ports to target “outbreaks” of fraud.

- 4) Training programs for textile and apparel import specialists should be re-initiated.
- 5) Two Customs staff should be stationed in the CAFTA/NAFTA region to do plant visits, rules training and coordination with foreign customs services.

NEW CUSTOMS TOOLS:

The following new tools should be considered in order to give Customs the ability to take strong and effective action against illegal imports.

- 1) Allow for seizures of goods which make inaccurate or unsubstantiated trade preference claims (currently Customs can seize goods for quota violations but the law has not been updated to allow seizures for false trade preference claims).
- 2) Eliminate blanket affidavits of origin and require affidavits to include specific amounts and other tracking information.
- 3) Create an electronic product verification system that would eliminate paperwork and allow Custom to compile real time data on CAFTA origin yarn and fabric usage and trade preference claims.
- 4) Allow for seizure of goods which are undervalued – undervaluation has become a major issue, particularly concerning goods from China.
- 5) Eliminate the ability of foreign companies to be importers of record for textile and apparel imports. This scheme allows unscrupulous importers to shield themselves from prosecution by using off shore entities.
- 6) Publish the names of companies that enter goods with false preference claims.
- 7) Publish regular statistics on usage of short supply provisions by the individual short supply petition.