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TESTIMONY OF

**CASS JOHNSON, PRESIDENT  
NATIONAL COUNCIL OF TEXTILE ORGANIZATIONS**

U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON WAYS AND MEANS, SUBCOMMITTEE ON TRADE

***“CUSTOMS TRADE FACILITATION AND ENFORCEMENT IN A SECURE  
ENVIRONMENT”***

THURSDAY, MAY 20, 2010

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Good afternoon, my name is Cass Johnson, President of the National Council of Textile Organizations (NCTO). NCTO is a trade association that represents the entire spectrum of the United States textile sector, from fibers to yarns to fabrics to finished products, as well as suppliers in the textile machinery, chemical and other such sectors which have a stake in the prosperity and survival of the U.S. textile sector.

I want to thank you for the opportunity to testify today on Customs Enforcement and Facilitation. There is no more important issue to the domestic textile industry than the integrity and enforcement of our trade agreements and obligations, and we deeply appreciate the Ways and Means Committee's interest in improving the Customs and Border Protection's ability to enforce trade agreements while ensuring that the flow of legitimate cargo is not impeded.

Last year, Harding Stowe, the CEO of R.L. STOWE MILLS, a 103 year old yarn spinner in North Carolina, testified before Congress on this very issue. He had just finished closing his last yarn plant in the United States and laying off his final 300 workers. He had watched his yarn export business be captured by companies that falsely claimed to be supplying U.S. made yarn for apparel made in the CAFTA region. He had identified the companies, identified the Pakistani yarn, sent information repeatedly to Customs and then was forced to stand back and watch his three-generation family business go under.

Harding Stowe's experience is not unique in our industry but it does have an added twist. In 2005, President George Bush flew down to Mr. Stowe's Belmont Plant in North Carolina and promised the workers there that if the textile industry supported CAFTA, then the industry would get the toughest Customs enforcement the industry had ever seen. He praised Mr. Stowe for looking ahead and supporting the creation of a new trading block that would bring new security and enhanced competitiveness to North Carolina's textile producers. (See Appendix: A 100 Year Old Yarn Plant Closes: A Case Study)

Six years after CAFTA passed, our industry is still wondering when that tough Customs enforcement regime is going to appear. In the interim, we have seen a rapid increase in illegal fraud coming out of the CAFTA and NAFTA regions as unscrupulous importers and producers have progressively discovered that there is very little that they cannot get away. This has meant good manufacturing jobs leaving this country because our members are losing more and more orders to Asian yarn and fabric producers that are illegally claiming their goods are made in the United States. The experience has left our members shaken and angry and many of them have lost faith in the government's commitment to defend them from illegal activity. It would be an interesting question to pose to them as to whether they would still support the CAFTA agreement today. That agreement, as you recall, was passed by two votes, both of which came from textile districts. Today, lack of faith in Customs ability to properly enforce textile provisions is a key reason that our industry opposes the Korean FTA. Our industry simply has no confidence that the systems, or lack thereof, for textile enforcement in the Korean FTA will be effective.

Trade agreements are the textile industry's lifeblood. Almost everything our members produce is exported to the CAFTA/NAFTA/ANDEAN region for assembly into garments and then re-exported to the United States duty free. Each of these agreements requires that goods, from the yarn stage to the final

garment stage (also called the “yarn forward” rule), be sourced from the region. This has helped to build a large textile and apparel sector in the Western Hemisphere – which covers ten countries, employs nearly two million workers and produces two-way trade in excess of \$20 billion dollars annually.

Because duties on textiles and apparel are relatively high, this trade is vulnerable to abuse. And, with little likelihood of getting caught, the incentive to cheat is high and lucrative. Unscrupulous importers can cut 15 percent or more off the cost of a garment by funneling illegal yarns, fabrics or garments through our FTA and preference regions claiming to be of U.S. origin. With textiles and apparel accounting for 46 percent of all Customs revenue collected, nearly \$12 billion a year, the stakes are enormous and the free trade areas have become a magnet for fraudulent activity.

There is additional fallout other than fraud where the U.S. Treasury is on the losing end, because duties are not being paid and penalties uncollected. A 2008 GAO report<sup>1</sup> found that Customs failed to collect half a billion dollars in AD/CVD duties and recent reports of extreme undervaluation of textile and apparel products coming from China could dwarf those figures. Through Customs own investigations, it has become increasingly clear that a large number of importers are deliberately undervaluing the value of their textile and apparel imports from China. We understand that there is a single case involving an importer of women’s apparel in New York where duty evasion could amount to \$50 million or more. Reports of undervalued Chinese goods entering into the Port of Los Angeles through phony front companies that are paid pennies a garment have become all too routine. Add Chinese undervaluation to duty evasion in the CAFTA/NAFTA/ANDEAN region and the loss to the U.S. Treasury is likely be over one billion dollars a year.

Another serious concern that underpins all this illegal trade activity – the possible threat to national security. If it is difficult or impossible to identify the true importer of the goods, then how confident can we be in the security of the system. As I will discuss later in this testimony, customs fraud has become a type of shell game where phony companies, phony agents and phony claims all work hand in hand in an orchestrated manner. The inability of CBP to crack down on these fraud networks reveals a serious hole in our national security network. If a phony resident agent can import undervalued Chinese apparel at little or no risk, that same phony agent could as easily import weapons or other dangerous materials that compromise the health and safety of our citizens.

With its impact on U.S. jobs, losses to the U.S. Treasury, and national security concerns, the area of commercial enforcement clearly needs new attention and new focus. CBP personnel are dedicated and hardworking and the top ranks of Customs are tasked with multiple and sometime conflicting priorities. As Customs responsibilities have grown to encompass new security issues and an increasing number of trade agreements, the agency’s budget and resources have remained static. In certain areas, such as commercial operations, resources have declined sharply relative to the rapid increase in imports coming onto U.S. shores. Customs has been forced to use a shrinking resource pie to deal with ever increasing problems. This phenomenon is nowhere better reflected than in the textile trade enforcement area.

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<sup>1</sup> U.S. GAO Report 08-391, “Antidumping and Countervailing Duties; Congress and Agencies Should Take Additional Steps to Reduce Substantial Shortfalls in Duty Collection” March 2008.

Over the past twenty years, the US textile and apparel industry has come to increasingly rely on exports to our trade preference areas. This new pattern of trade – the sending of yarn and fabric components to the CAFTA/NAFTA/Andean region for return as finished garments to the United States – has created the need for more sophisticated enforcement regimes. These regimes must now seek to ensure that not only the final product, the garment, is made in a trade preference country, but that yarn and fabric components are also produced there.

These new requirements – which are so important to the livelihoods of millions of workers both inside the United States and in the trade preference regions themselves – have posed new and unique challenges for the CBP. In the past five years, the textile industry – as well as the CBP – has discovered that many of the enforcement mechanisms that were originally devised have failed to meet the high standards to which they aspired.

As a result, today, our members report seeing much more illegal activity than they did five or ten years ago. There is a general feeling that fraudulent importers and producers have identified the loopholes in the system and how to utilize them for their benefit. At the same time, it also seems clear that Customs ability to pursue commercial textile fraud has been hampered by declining budgets, other priorities and inadequate tools. As a result, our industry has conducted its own internal investigations into why fraud seems to be increasing and we have are now at a point where we believe that there are concrete steps that can be taken by the Congress to help Customs better target its enforcement efforts in the commercial trade arena.

Tomorrow, congressional leaders from textile states will be introducing a textile customs enforcement bill. This bill, the Textile Enforcement and Security Act of 2010, has been the by-product of a year- long review by NCTO and its member companies of the problem of textile customs enforcement. This review has been aided by discussions with our member companies, the CBP personnel, staff at the Commerce Department and USTR as well as companies that import textile and apparel products from trade preference areas.

Several areas that we focus on are the direct result of projects and strategic operations that Customs itself has put into place over the last several years as it has attempted to get a better grip on textile customs enforcement issues. Other issues are the result of broader concerns that the textile industry shares with other industry groups. Still other measures are the result of concerns regarding paperwork burdens and other measures that may unfairly encumber trade. All in all, we have tried to address existing concerns in a manner that would provide Customs with useful and supportive initiatives to better combat commercial fraud and increase trade facilitation. We look forward to reviewing our proposals with the Committee and the CBP.

Specifically, as a result of our investigation, we came to the following key findings:

1. Customs verification systems regarding free trade and preference area claims are burdensome on importers and yet provide Customs with very little helpful information.
2. Customs can do a better job of matching import specialist assignments to high trade ports.

3. Importers that do not reside in the United States and are therefore outside this country's legal authority have become difficult to manage and has become a source of fraudulent activity and deserves new scrutiny.
4. Customs needs additional resources and focus to combat undervaluation of goods, particularly from China.
5. Customs does not have sufficient resources to effectively partner with foreign customs services, particularly in the free trade areas.
6. The Justice Department discourages commercial fraud cases, and this discourages high publicity prosecutions that could send a strong message.

#### REVIEW OF KEY FINDINGS:

1. Customs verification systems regarding free trade and preference area claims are burdensome on importers and yet provide Customs with very little helpful information.

One of the major reasons for the increases in fraud in the free trade and preference areas is that the basic system for detecting fraud has broken down over the weight of illegal activity being perpetrated. The basic textile customs enforcement system was devised during the NAFTA negotiations and it has proven increasingly unable to cope with the level of fraud now facing it. During NAFTA, the prevalent concern regarding textile customs enforcement was the evasion of quotas in place on Asian producers; fraud in the NAFTA region was relatively small. Today, quotas are no longer in place and the scope of fraudulent activity has now shifted to the trade preference areas. As trade preference and free trade areas have expanded, so has the realization that the rewards for bringing in goods illegally labeled as made in an FTA country are enormous.

The original NAFTA model that was predicated on relatively low levels of fraud could sustain a relatively resource intensive response that the NAFTA customs enforcement model required. That model no longer works well in today's changed environment. For example, under the current NAFTA model, Customs requires that importers of record verify that they meet the rules of origin for textile and apparel products on a shipment by shipment basis. They do this by claiming a duty preference and they are required to have paper documentation to back their claim up. However, most fraud – and almost all fraud reporting – comes at a stage in the import process that is several steps removed. Typically, fraud occurs when Asian yarn or fabrics are substituted for U.S. yarns or fabrics. This takes place either when the goods are knit or woven or when they are sewn together. Thus when fraud takes place, the importer of record often has no idea that the fraud has occurred – all he or she has required of the apparel manufacturer is that they agree to provide CAFTA or NAFTA qualifying goods.

Unfortunately, the need for systems to track whether the apparel or the fabric manufacturer actually are in compliance with the conditions and requirements of the FTA was not seen as necessary when the current enforcement model was developed. And because there are no systems in place, Customs

investigations of fraud are enormously time consuming and resource intensive. For instance, when a U.S. yarn producer discovers that they have lost orders to a phony company, they typically contact CBP with the information. They can usually supply the name of the fabric producer and the name of phony yarn company— typically a knitter in Central America – that has been sold the phony goods (usually at a very cheap price). Customs, however, needs to know the name of the importer of record in order to proceed with a fraud penalty. Under the FTA rules, Customs can only penalize the importer of record – no one else in the supply chain can be penalized or held accountable. However, in 99 percent of all fraud cases, the U.S. textile mill has no idea who is listed as the importer of record at the port of entry. (See Appendix: Case Study- Yarn Textile Fraud – An Open Secret)

In order to find the importer of record, Customs must begin a laborious and often futile effort which requires that it contact the knitting mill where the phony yarns or fabrics were sent. Because the knitting mill is typically outside the country, Customs sends a production verification team to the knitting mill and examines its records. The fabric manufacturers' records show where the yarns came from and where the knit fabric (which may contain the illegal yarns) are sent. Customs must then visit the apparel manufacturer who is also most likely to be outside the country. It must send another production verification to that manufacturer to determine which garments were made of the fabrics sent from the knitting mill. Once Customs determines which garments contain the illegal fabrics then Customs can begin to assign rate advances to the importer of record who, knowingly or not, improperly claimed a trade agreement preference rate.

The system has also become further compromised by the use of “blanket affidavits.” “Blanket affidavits” allow the importer of record to get an affidavit from a yarn or knitting mill that certifies that all products sent to the importer are FTA qualifying. Importers typically insist on these affidavits because sending paperwork along the production chain on a shipment by shipment basis is cumbersome. However, when Customs investigates a fraud claim through the importer of record, an importer of record typically responds with blanket affidavits from U.S. mills certifying that the products sent to the apparel manufacturer are FTA qualifying.

Customs is hamstrung because it can only penalize importers on a shipment by shipment basis but blanket affidavits are typically used to cover dozens or even hundreds of shipments. There is simply no way that Customs can verify whether the yarns or fabrics that are covered by a blanket affidavit are actually those used in a particular shipment. To make matters worse, blanket affidavits are now being used as “cover” to shelter illegal activity. Today, a knitter in Central America may buy a small amount of U.S. made yarn and repeatedly use the same blanket affidavit to “cover” his or her purchases of Pakistani or Chinese yarns and fabrics.

In the last five years, it has become clear to NCTO and its member that major changes are needed to the free trade area enforcement model if fraud is to be brought under control. Experience has show that the current model does not achieve the objective of being both facilitative of trade and an effective enforcement mechanism.

One possible change is an electronic tracking system that would allow Customs to get aggregate data by yarn and fabric mills to show how much product is actually being produced for each importer of record. This system would allow Customs to match actual U.S. textile exports to claims of duty preferences for imported goods. The system would be relatively easy to construct and would involve entering in the entry document a two digit code that would identify a particular yarn or fabric plant where the components originated. While this type of system would require importers to more closely track components as they move through the production chain, it would eliminate the need for paper records and would also reduce the number of verifications that Customs now must conduct.

The later point is an important one: to find fraud today, Customs must often cast a wide net, reeling in information from importers from dozens or hundreds of shipments to catch a single fraudulent entry. This is disruptive, expensive and time consuming for importers. And many times large and compliant producers are targeted repeatedly for investigations. With an electronic based tracking system, this type of intrusive investigation would be sharply curtailed.

Another possible change is the creation of an account based system that could verify that certain verification procedures were used at the yarn, fabric and apparel manufacturing stage to ensure that only legal goods were getting duty free entry. Today, Customs has no means to compel producers at any stage in the process to keep good records, to segregate compliant versus non-compliant goods and to do proper inventory control. As a result, more often than not, the only record keeping is a blanket affidavit. A comprehensive account-based system that would reward good behavior and good systems and allow Customs to better target bad players could help reduce the likelihood of fraud. The current Automated Commercial Environment System (ACES) program being implemented, which is both electronic and account based, could serve as a useful tool in this effort if the data could be used for export and import commercial verification and if tracking of textile component parts for claims of duty free preferences in free trade areas were added.

## 2. Customs can do a better job of matching import specialist assignments to high trade ports.

Last year, the Small Business Committee's Subcommittee on Rural Development, Entrepreneurship and Trade held a hearing on textile import enforcement which highlighted many of the concerns NCTO is raising today. As a result of last year's hearing on textile customs enforcement by the Small Business Committee, NCTO discovered that Customs allocation of import specialists trained in textile and apparel verifications no longer matches the high risk profile of textile trade today. Import specialists are the front line troops in the effort to combat commercial textile fraud and data clearly show that most commercial fraud is being found in free trade areas. However, import specialist assignments do not reflect that shift in fraud. Today, import specialists that were trained specifically to do textile and apparel verifications are often assigned to ports that receive very little preference area textile trade. And the largest ports that do textile and apparel trade verifications now turn out to have relatively few trained specialists assigned. For instance, data show that Customs has assigned only 6 percent of all trained import specialists to the ports that handle 44 percent of all textile and apparel trade preference claims.

<b>Import Specialists Trained to Do Textile and Apparel Preference Verifications Vs. Actual Port Textile and Apparel Claims</b>				
Port	Textile and Apparel Preference Trade (TAPT)	Percent of Total TAPT	Textile and Apparel Trained Specialists	Percent of Total Trained Textile and Apparel Import Specialists
Miami – Port Everglades	\$4.0 billion	23%	8	2%
Laredo, TX	\$1.8 billion	10%	7	2%
Gulf Port/El Paso	\$1.9 billion	11%	5	2%
TOP T&A PORTS	\$7.7 billion	44%	20	6%
<i>Source: US Customs Service. Data is for the top 25 ports processing textile and apparel preference claims. There are 329 import specialists trained to do textile and apparel verification claims.</i>				

Looking at specific ports, we discovered that there were only 8 textile and apparel specialists dedicated to the top two –Miami and Fort Everglades- textile and apparel ports (by value) to handle import verifications. These two ports alone import more than \$4 billion worth of textile and apparel trade preference claims annually. And yet, the Champlain, NY port which handles only \$501 million in preference claims has 11 textile and apparel import specialists. These types of disparities are troublesome and we believe the Customs needs to move more quickly to redirect its resources towards high risk areas of textile enforcement. (It is important to note that these specialists, while trained in textile and apparels, also handle other import verifications.)

The problem with staffing reaches higher up in the organization as well. Since the Textiles Office was transferred into the Office of Trade, staffing has fallen dramatically and many senior staff with decades of experience have left the office either through retirement, transferring back to Operations or to the private sector. The office is severely short staffed at a time when commercial fraud has increased dramatically. This decline in staffing has had an impact –commercial fraud figures show that Customs is interdicting sharply less illegal textile and apparel goods than before its move to the Trade Policy office – penalties have fallen by 50 percent since the office was moved. Customs needs additional resources so that it can bring the office that directs textile enforcement efforts up to full staff.

3. Importers that do not reside in the United States and are therefore outside this country’s legal authority have become difficult to manage and has become a source of fraudulent activity and deserves new scrutiny.



Non-residents are required to designate a resident agent in the state for which the port of entry is located. However, the resident agent is not held accountable should the imports be undervalued, or if the nonresident importer is unable to be located to collect duties or penalties. We are concerned that issues regarding this program which are already being raised in conjunction with food safety, toys and goods under dumping and countervailing duty orders are now spreading to the textile and apparel area. It appears that fraudulent actors are increasingly aware of how to game the system. This is done by setting up a resident agent as the “fall guy” for the non-resident importer who remains safely offshore and out of Customs’s reach. However there is no real “fall” in terms of the money lost to the U.S. Treasury because the resident agent is not held accountable for penalties. Thus, even when fraud is discovered, there is no way for Customs to successfully punish the offender. This is a complex issue which we know that Customs is grappling with and we urge the Committee to work with Customs to find answers to address this issue.

4. Customs needs additional resources and focus to combat undervaluation of goods, particularly from China.

With the removal of quotas and safeguards, as well as the downturn in the economy, we have received numerous reports of undervaluation schemes. These schemes are an effort to pay minimal duties on high tariff value products. While the majority of these occurrences have been focused on avoiding countervailing duty and anti-dumping orders, such as with honey, Customs has been investigating a significant problem with undervalued textile and apparel products coming from China. At present, CBP lacks the dedicated resources to go after this illegal trade in a comprehensive manner. The amount of duty evasion appears to be significant – a single case may total over \$50 million in lost duties – and this means that losses to the U.S. Treasury are steep and could total hundreds of millions of dollars. While it is next to impossible to physically examine every shipment that enters U.S. ports, systems could be set up to target goods that come in at abnormally low prices. Garments that are imported for less than the cost of the raw materials would be flagged for increased scrutiny. The textile industry would be happy to assist in such a project.

5. Customs does not have sufficient resources to effectively partner up with foreign customs services, particularly in the free trade areas.

Customs could do a better job of investigating fraud claims if they were given the resources to partner with their fellow customs services. Improved coordination and sharing of data would shorten the length and scope of investigations, increase Customs ability to track shipments and locate importers of record and send an important message to fraudulent producers that multiple sets of eyes are watching. While CBP has attempted to do training with FTA partners regarding custom textile enforcement, budget constraints have hampered their ability to do this in a comprehensive and effective manner.

A recent fraud issue regarding denim trousers from Mexico provides a good example. The Mexican textile industry has become increasingly concerned about large imports of Chinese denim going into Mexican maquiladoras. The maquiladoras are established solely for export of final products to the United States but U.S. import statistics show that almost all goods coming from the maquiladoras are

declared to be made of U.S. or Mexican denim fabric. This illegal trade has grown to be enormous with millions of pairs of denim trousers claiming NAFTA origin but which are actually made of Chinese denim fabric. On top of this problem, conflicting information from U.S. export data and Mexican import data shows that importers are bringing in Chinese denim “in bond” from the port of Los Angeles/Long Beach and then declaring it as U.S. fabric when it is exported across the border. Because there is no shipment to shipment match or sharing of information between U.S. Customs and Mexican Customs on “in bond” goods, it is difficult for either branch to determine when and where fraud is occurring. Developing communication lines between our Customs official and our trading partners will help both sides to identify fraudulent activity and the fraudulent players.

6. The Justice Department discourages commercial fraud cases and this discourages high publicity prosecutions that could send a strong message.

Currently the CBP sends cases to Immigration and Customs Enforcement (ICE) which are then referred to Department of Justice. However, very few cases are ever prosecuted. ICE appears to lack the technical capability to thoroughly investigate these textile and apparel matters and the DOJ’s clear lack of interest in prosecuting such cases further discourages investigation of high level cases.

#### CONCLUSION:

The focus of this hearing is on Customs Commercial Enforcement and Trade Facilitation. The need for new thinking and new direction in this area is clear and Customs deserves stronger support in terms of resources and improved guidance from Congress in terms of focus. New resources and guidance will pay off in multiple ways: Customs will be able to expand current initiatives and make them more effective; fraudulent players will be increasingly deterred and significant amounts of production— and jobs – will return to this country; the Treasury will see a significant increase in duties collected; and, finally, a weak link in our country’s security umbrella will be closed. In addition, enforcement concerns by industry will diminish and this will help diminish opposition to new trade agreements.

Tomorrow, NCTO will introduce a textile customs enforcement bill. This bill is intended to close many of loopholes that exist today in textile customs enforcement through providing new resources, new tools and a more targeted approach to problem of textile customs fraud. It is also intended to help Customs become more efficient in its fraud investigations and therefore to facilitate trade among good players while enabling Customs to crack down on bad players. We hope that this bill will be helpful to the Committee as it reviews options for moving ahead. NCTO appreciates the Committee’s consideration of this bill and thanks the Committee again for initiating this hearing on this important subject.

APPENDIX:

## **CASE STUDY #1: Yarn Textile Fraud – An Open Secret**

**By Dan Nation, President of Parkdale Yarns. June, 2009**

Parkdale Mills is a privately held yarn spinning company based out of Gastonia, NC. Our company began operations in 1916. At the peak of our growth, Parkdale operated 38 facilities in four states employing over 4000 people. In the last 12 years, we have been forced to close 19 of these facilities; resulting in over 2,200 jobs lost not including all of the adjacent jobs supported by these manufacturing jobs. All of these facilities were located in small towns throughout the Southeastern U.S. These towns have lost the majority of their manufacturing tax base, creating further financial stress.

Conservatively, we estimate that 1200 of the 2,200 Parkdale jobs had to eliminate could have been saved with 100% effective Customs enforcement over the last six years. Evidence of Customs fraud in yarn shipments to NAFTA and CAFTA countries has grown exponentially. As shipments to Central America grew after Caribbean Basin Initiative (CBI) and CAFTA, distributors and certain customers we were selling to in the region began asking for multiple original affidavits on the same shipment of yarn. Yarn spinners are required to provide an affidavit certifying that the yarn is produced in the U.S., giving the garment it is made into duty-free access back to the U.S. Also, we began to see forged affidavits from Parkdale originals and from companies that were out of business or that do not exist. Duty avoidance makes these companies more competitive with pricing, which takes U.S. jobs away from very competitive U.S. companies.

One of the most blatant cases involves a shell company named Yarns America ([HTTP://YARNSAMERICA.COM](http://YARNSAMERICA.COM)). On their website (copy attached), they claim to have 526,400 spinning spindles in NC, SC, and AL, producing 5,000,000 pounds per week of yarn. Spindle is the industry terminology used to quantify the yarn producing capacity of a machine, plant, or company. If this information were accurate, Yarns America would produce twice as much ring spun product as Parkdale. We know details of every yarn spinning company operating in this Hemisphere. This company does not exist. Our salesmen that cover the CAFTA market continually see affidavits for yarn from this company certifying U.S. origin. They have also seen yarn in customer facilities labeled "Yarns America" that was obviously foreign-made due to the packaging and in foreign containers that could not have been shipped from the U.S. We notified U.S. Customs two years ago of this issue. We know that Customs has tried to get to the bottom of this problem, but, to-date, there has been no resolution and Yarns America continues its illegal operations.

Data published by the U.S. government (attached) also supports that non-qualifying yarns are illegally submitted as U.S.-produced product. In 2008, the difference between domestic exports and U.S. production totals 42,768,751 kilograms (or 196,023 bales of cotton). The deficit between exports and the total of production and imports wrongly indicates that no combed cotton yarn is consumed domestically. The difference is equivalent to the production of nine average-sized U.S. mills. Not coincidentally, at least seven U.S. combed cotton yarn mills have closed since the beginning of 2008. Barring a change in this situation, more closings are imminent. This is certainly proof positive that the level of fraud is immense.

There are numerous smaller Asian-owned apparel companies in the CAFTA Region that will purchase multiple containers of Asian yarn to every single container of U.S. yarn. Utilizing the affidavit on the U.S.

yarn, with no continuous system of checks and balances from U.S. Customs, they can report all of these garments manufactured from U.S. yarn, when the actual U.S. yarn consumed is a fraction of the total. We can verify that 2.5 to 3 million pounds of Asian yarn per month is imported into CAFTA, which does not violate any trade laws. However, we cannot verify that duty is paid on all of the garments produced from this yarn. We can look at one product in particular, 40/1 combed cotton, and see that many more pounds of garments enter the U.S. duty-free made from that product that is exported from the U.S. and produced in the CAFTA Region.

## **Case Study #2: A 100 Year Old Yarn Mill Closes**

**By Harding Stowe, President of R.L. Stowe Mills – June 2009**

Good morning, Chairman Shuler, Ranking Member Luetkemeyer and members of the subcommittee, my name is Daniel Harding Stowe. I am President and CEO of R.L. Stowe Mills. R.L. Stowe Mills ceased operations in the first quarter of 2009 and is going through the process of liquidating its plants and real estate. I am testifying at the hearing today because lack of effective customs enforcement was an important factor in our decision to close the business. It is my hope that by contributing to this hearing other American textile companies that still remain in business will have a future in our industry.

Our company was organized in 1901 and began operations in 1902. At its peak the company employed over 1,500 people in eight facilities. We produced yarns for many markets and product applications. These markets included apparel, hosiery, home furnishings, industrial, medical and military. Being in business for more than a century caused R.L. Stowe Mills to react to changes involving the market and adapt our processes and products to the demands that the market dictated. One market that was especially important to us was the knitted shirt industry in Central America because we had developed an extensive customer base that purchased fine count cotton yarns. We were able to grow our export business from 3% of our sales in 1999 to over 40% of our sales in 2008.

Almost all of this growth came from the CAFTA region and much of it in Guatemala. The Caribbean Basin Initiative allowed us to build strong supply chains into the region with our yarn. R. L. Stowe along with the textile's industry's principle trade group, the National Council of Textile Organizations supported the Central America Free Trade Agreement. The industry felt that by joining together with our Central American trading partners and customers would allow us to best compete with the overwhelming Chinese trade flows that were rapidly taking market share in most of the textile and apparel product categories.

Customs enforcement is a critical component in any trade agreement. It is especially true with CAFTA because of the many countries involved and the volume of goods being transferred between countries. We sought and were given assurances from the White House on down that enforcement would be diligent and given the highest priority. This was particularly important because we had discovered during the CAFTA debate that Customs had not hired over 72 textile and apparel specialists that Congress had appropriated money for several years before. We therefore asked for and got assurances that the CAFTA enforcement efforts would be stronger and more comprehensive than ever before.

As a matter of fact, our company hosted a presidential visit during the critical time that CAFTA was being debated. Former President George W. Bush toured our mill in July of 2005 and spoke to our employees on the importance of the CAFTA agreement. Privately I discussed with him the threat that Chinese exports into the US were having on the mill. To be clear, the promise of a unified Western Hemisphere business strategy to better compete with Chinese goods was the driving force behind our support for CAFTA along with the all but guaranteed increase in enforcement in what is now the CAFTA region.

Based on these assurances the textile industry provided the needed support to win passage of CAFTA, yet after CAFTA passed, enforcement of our customs laws grew weaker, not stronger. In fact, lack of customs enforcement was an issue almost from the beginning of CAFTA. The agreement was only one year old when the textile enforcement division was abruptly moved from Operations to a new policy branch. The industry protested loudly at this action – it made no sense to take what was primarily an enforcement division and move it to a policy division. This was particularly upsetting because Customs had done exactly the same thing back in the late 1990s – and had such problems with its enforcement efforts that textiles was transferred back to Operations. Now, a year after our commitments from the government, it was happening again.

2006 was good year for R. L. Stowe. We shipped over 11 million pounds of 30/1 and 2.5 million pounds of 40/1 much of it into the CAFTA region. We were operating four ring spinning plants and had seen constant growth in the region since we had entered the market in 2001. It was at the end of 2006 and early 2007 that we began to see blatant evidence of imported yarn being used from companies that either didn't exist, or were shipped with forged Affidavits of Origin claiming U.S. origin. In some cases, affidavits claimed that the yarn was made by R.L. Stowe.

In 2007, the problem had gotten so bad that representatives from RL Stowe Mills, Frontier, Parkdale and Tuscarora met with Matt Priest, the head of the Office of Textile and Apparel (OTEXA) to discuss the problem of falsified customs documents (fake "affidavits of origin") and the precipitous drop in the prices for yarn "Made in U.S." for use in CAFTA goods.

It was about this time that we first began to hear discussions of US companies that we knew did not exist. Our customers in the CAFTA region were suddenly being offered cheap fabric from California that was labeled "CAFTA qualified", but at price points that were significantly lower than fabric that could be produced in either the United States or the CAFTA region.

As a result, for two of our primary yarn counts into the region, in 2007 our overall sales of 30/1 sales fell from 11 million to 5.8 million and 40/1 sales fell from 2.6 million to 1.9 million while our sales to California over-all were down by 70-80% for natural yarns. We were now regularly being told that U.S. made yarn was "too expensive" and could not compete – yet U.S. yarn<sup>2</sup> was required to get CAFTA benefits. Yet many of our traditional California customers were exporting CAFTA qualifying fabric to Central America. We reported our concerns to Customs through NCTO.

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<sup>2</sup> There was no significant yarn production in the CAFTA region, therefore U.S. yarn was "de facto" required.

As evidence, we provided proof of falsified documents alleging CAFTA origin but when we submitted them to Customs, we were told they could not do anything until the goods came back into the U.S. Then we were told that because we did not know the name of the importer of record who brought the goods in, it would be very difficult, if not impossible, for Customs to trace the records back and take action. This was all very frustrating because we knew the knitters and in certain cases the cut and sew companies who were getting illegal goods and we knew who was sending them the illegal goods but this was still not enough information for Customs to crack down. Getting this information sometimes put the sources of our information at risk in terms of both their jobs and their well being and the lack of Customs follow-through made it difficult to gather more information.

Even after new assurances from Customs that it would move aggressively, fraudulent activity continued to increase with shell companies openly advertising their product as U.S. made yarn and offering false certificates of origin. By the fourth quarter of 2008, Central America was flooded with fraudulent yarn. Shipments and prices declined rapidly and in December because of these conditions and softening in other markets we made the decision to close RL Stowe Mills after 108 years and three generations in business.